

86 1527 (2)

NO.

Supreme Court, U.S.
FILED

FEB 20 1987

JOSEPH F. SPANIOL, JR.
CLERK

IN THE
SUPREME COURT
OF THE
UNITED STATES

October Term, 1986

McCLELLAN REALTY COMPANY, et al.,

Petitioners,

v.

UNITED STATES OF AMERICA, et al.,

Respondents.

Petition for a Writ of Certiorari to the
United States Court of Appeals for the
Third Circuit

LAWRENCE M. LUDWIG (Counsel of Record)
HENKELMAN, KREDER, O'CONNELL & BROOKS
Bank Towers Building
Scranton, Pennsylvania 18503
(717) 346-7922

JOSEPH R. SOLFANELLI
GERALD J. BUTLER
SOLFANELLI & BUTLER
Counsel for Petitioners

Dated: January 22, 1987

EDITOR'S NOTE

THE FOLLOWING PAGES WERE POOR HARD COPY
AT THE TIME OF FILMING. IF AND WHEN A
BETTER COPY CAN BE OBTAINED, A NEW FICHE
WILL BE ISSUED.

UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF PENNSYLVANIA

UNITED STATES OF :
AMERICA, :
 :
Plaintiff :
 : Civil No. 80-1424
vs. : (Reassigned to
 : Judge Muir
 : 3/5/81)
GLENEAGLES INVESTMENT :
CO., INC., et al., :
 :
Defendants :

OPINION

MUIR, District Judge.

I. Introduction.

This action was commenced by the United States on December 12, 1980, by the filing of a complaint and a motion for a temporary restraining order. Subsequently, four amended complaints have been filed. In the fourth amended complaint, filed May 17, 1982, the United

States (1) seeks to reduce to judgment alleged delinquent federal income taxes, interest, and other penalties assessed and accrued against Defendant Raymond Colliery Co., Inc. (Raymond Colliery) and its subsidiaries for the fiscal years ended June 30, 1972 and June 30, 1973, and against Defendant Great American Coal Co., Inc. (Great American) and its subsidiaries, including Raymond Colliery, for the fiscal year ended June 30, 1975; and (2) seeks to collect these tax claims and tax claims previously reduced to judgment in United States of America vs. Raymond Colliery Co., Inc., et al., Civil No. 79-1168, slip op. (M.D. Pa. October 10, 1980), from surface and coal lands presently owned by Raymond Colliery as well as from lands formerly owned by Raymond Colliery but which, as a result of allegedly illegal and fraudulent coun-

ty tax sales, are now owned by Defendant Gleneagles Investment Co., Inc. (Gleneagles). Jurisdiction of this Court is invoked pursuant to 26 U.S.C. Secs. 1430 and 1445 as well as 26 U.S.C. Secs. 7402-(a) and 7403.

On October 10, 1980, this Court granted judgment in favor of the United States and against Raymond Colliery and its subsidiaries for assessed and unpaid federal income taxes for fiscal years 1966, 1967, 1968, 1969, and 1971 in the amount of \$2,795,795.16 plus interest. United States vs. Raymond Colliery Co., Inc., et al., Civil No. 79-1168, slip op. (M.D. Pa. October 10, 1980). On September 17, 1982, this Court granted the motion of the United States for partial summary judgment with respect to its attempt to reduce to judgment its claims against Raymond Colliery for the tax

years ended June 30, 1972 and June 30, 1973. Judgment was entered in favor of the United States and against Raymond Colliery and its subsidiaries in the amount of \$119,704.08 for unpaid interest for the fiscal year ended June 30, 1972 and in the amount of \$16,800.00 for unpaid taxes and \$9,462.19 for unpaid interest for the fiscal year ended June 30, 1973. United States vs. Tabor Court Realty Corp., et al., Civil No. 80-1424, slip op. (M.D. Pa. September 17, 1982). Thus, the United States presently has judgments against Raymond Colliery and its subsidiaries for all of the involved tax liabilities except those alleged to be due for the fiscal year ended June 30, 1975.

The United States contends that as a result of its judgments and other claimed taxes it has substantial liens against

properties now held or once held by Raymond Colliery and its subsidiaries. In addition to the liens held by the United States, many other persons hold liens against these properties. One purpose of the United States in instituting this lawsuit is to assert the priority of its liens over liens held by other persons. Those lienors named as additional Defendants in this lawsuit are General Electric Credit Corporation, the Commonwealth of Pennsylvania, the Borough of Olyphant, John J. Gillen, Thomas J. Gillen, Robert W. Cleveland & Sons, Inc., William T. Kirchoff, J.W. Cleveland, the Estate of Royal E. Cleveland, the City of Scranton Sewer Authority, the Lackawanna River Basin Authority, the Borough of Taylor, Lackawanna County, William R. Henkelman, and McClellan Realty Co., Inc. (McClellan). Also named as Defendants are Jeddo



Highland Coal Co., Pagnotti Enterprises, Inc., Loree Associates, Blue Coal Company, Gillen Coal Mining Co., Carbondale Coal Co., Moffat Premium Anthracite, Northwest Mining, Inc., Maple City Coal Co., Powderly Corporation, Clinton Fuel Sales, Inc., Olyphant Premium Anthracite, Inc., Olyphant Associates, Minindu Corporation, Glen Nan, Inc., Gilco, Inc. and Joseph Solfanelli, individually and as trustee. Blue Coal and Glen Nan went into bankruptcy in December of 1976 and the interests of those companies are asserted herein by James Haggerty, the trustee in bankruptcy (the Trustee). See In re Blue Coal Corp.--Bankrupt, BK 76-1311 (M.D. Pa., petition filed Dec. 16, 1976); In re Glen Nan, Inc.--Bankrupt, BK 78-604 (M.D. Pa., petition filed Dec. 16, 1976).

In order to collect its judgments for

delinquent tax liability, the United States seeks in this lawsuit to foreclose its tax liens against and to sell the property owned by Raymond Colliery and its subsidiaries (hereinafter sometimes called the "Raymond Group") at the time the tax assessments were made. This property falls into two categories, lands presently owned by the Raymond Group and lands formerly owned by the Raymond Group. According to the complaint, as to the second category, because of the failure of Raymond Colliery and Blue Coal to pay certain delinquent real estate taxes, Lackawanna County and Luzerne County scheduled tax sales for December 17, 1976 of certain Raymond Colliery and Blue Coal real properties. Substantially all of the Raymond Colliery properties advertised for sale were purchased by Defendant Tabor Court Realty Corp. (Tabor

Court) for the upset bid of \$385,000.00. The United States contends that the Lackawanna County Tax Claim Bureau failed to give adequate notice of the 1976 tax sale to the Internal Revenue Service. Accordingly, the United States claims, pursuant to 26 U.S.C. Sec. 7425, that even if the 1976 tax sale was a bona fide tax sale it would have no effect on the federal tax liens filed prior to the date of the sale. Because thereafter Tabor Court did not pay certain real estate taxes on the Raymond Colliery properties, Lackawanna County scheduled a second tax sale of the Raymond Colliery properties for December 16, 1980. At the December 16, 1980 tax sale, Joseph Solfanelli, a Defendant in this action, purchased the properties for \$612,239.56. In January of 1981, Glen-eagles was incorporated in Pennsylvania with Joseph Solfanelli as its sole share-

holder. The properties were subsequently transferred directly to Gleneagles by the Lackawanna County Commissioners by deed of April 15, 1981. The United States challenges both the December 17, 1976 and December 16, 1980 tax sales in this lawsuit.

In addition, the United States seeks to set aside as fraudulent conveyances under Pennsylvania's Uniform Fraudulent Conveyances Act, 39 Pa.Cons.Stat. Sec.351 et seq., certain mortgages purporting to encumber the lands of Raymond Colliery and its subsidiaries. These mortgages were delivered on November 26, 1973 to Institutional Investors Trust (IIT) to secure certain loans made by IIT allegedly to finance the purchase of the stock of Raymond Colliery by Great American, the newly formed parent of Raymond Colliery. The mortgages were assigned to

McClellan on January 26, 1977. The United States asserts that the mortgages are void in the hands of McClellan because McClellan had knowledge that the mortgages were fraudulent conveyances.

In addition to the claims of the United States, certain Defendants in this lawsuit, the Commonwealth of Pennsylvania, and the Trustee in Bankruptcy of Blue Coal and Glen Nan have substantial claims against the other Defendants. Indeed, while the Commonwealth and the Trustee are nominal defendants, their interests are largely aligned with those of the United States and this case has been tried so far almost as if the Commonwealth and the Trustee in Bankruptcy were co-plaintiffs. The Commonwealth claims to have liens in the amount of \$1.8 million against the properties now held or once held by Raymond Colliery and

its subsidiaries. Like the United States, the Commonwealth seeks a judgment declaring void the IIT mortgages so that the Commonwealth may also foreclose on its liens and sell the properties free and clear of the mortgages. The Trustee also seeks to have the IIT mortgages set aside and has filed a crossclaim against some of the other Defendants in this lawsuit. The Trustee, of course, under the Bankruptcy Act can assert the rights and powers of any actual creditor of the bankrupt corporations in challenging any transfer or obligation incurred by those companies. 11 U.S.C. Sec. 110(c)(1970). The Trustee desires to liquidate Blue Coal and Glen Nan assets free and clear of the IIT mortgages for the benefit of the creditors of those corporations.

This case was placed on the Court's November 1982 trial list to be tried

without a jury on the liability issues which were claimed to be interrelated. Trial commenced on November 3, 1982. By order of December 30, 1982, when no evidence had been presented on the second liability issue, the undersigned directed that only the first issue of liability, denominated as the validity of the 1973 mortgages, be tried at that time. Trial on the first issue of liability concluded on March 17, 1983 for a total of 68 trial days. The Court is now trying the second liability issue. Subsumed in the first issue are the questions of whether the IIT mortgages were fraudulent conveyances and whether the IIT mortgages were otherwise void because they were executed for illegal and ultra vires purposes. Also included within the first issue is whether the selling shareholders are liable for breaching any duty to creditors of

the Raymond Group of corporations or to the corporations themselves by participating in a transaction whereby the corporations immediately used the IIT loan proceeds to finance the purchase of the Raymond Colliery stock and whether the payment of the loan proceeds to the selling shareholders was a fraudulent conveyance. All other issues in this case are to be tried subsequent to the Court's decisions on the first and second issues.

Following are the Court's findings of fact, discussion, and conclusions of law with regard to the first issue of liability. Issuance of this decision was delayed approximately one month because additional briefing was required on questions relating to the liability of the selling shareholders of the Raymond Colliery stock.

II. Findings of Fact.



1. Raymond Colliery was incorporated in approximately 1962 as a Pennsylvania corporation.

2. Raymond Colliery owned the stock of other corporations engaged in coal mining and sales. Raymond Colliery also owned land and tangible assets in Lackawanna County, Pennsylvania.

3. The stock of Raymond Colliery was owned or controlled between 1962 and 1973 by the following persons, all of whom are Defendants: Thomas J. Gillen, John J. Gillen, Robert W. Cleveland, Robert W. Cleveland, Jr., Jay W. Cleveland, Royal Cleveland, and William T. Kirchoff (hereinafter "the Gillens and Clevelands").

4. Sometime prior to 1973, Robert W. Cleveland and Robert W. Cleveland, Jr. transferred their stock in Raymond Colliery to Defendant Robert W. Cleveland & Sons, Inc.

5. Royal E. Cleveland died after this action was instituted and Jay W. Cleveland, the administrator of the Estate of Royal E. Cleveland, has been substituted in his stead.

6. Prior to 1962, Thomas J. Gillen and John J. Gillen had been in the business of coal mining, doing business primarily under the name of Gillen Coal Co. or its successors.

7. In addition to their involvement with Raymond Colliery, Jay W. Cleveland, Robert W. Cleveland, Robert W. Cleveland, Jr. and Royal Cleveland were in the business of earth-moving equipment sales and land development, doing business as Cleveland Brothers Equipment, Inc.

8. Raymond Colliery acquired most of its lands and other tangible assets from the Glen Alden Corporation (Glen Alden). (Undisputed, hereinafter "U")

9. Glen Alden was a corporation engaged in coal production located in the Wilkes-Barre-Scranton area of Pennsylvania.

10. Glen Alden owned Blue Coal Corporation (Blue Coal), a company engaged in coal production.

11. The bulk of Blue Coal's land and other assets was located in Luzerne County. (U)

12. In 1966, Glen Alden sold all the stock and assets of Blue Coal to Raymond Colliery for \$6,000,000. Raymond Colliery paid Glen Alden \$500,000 in cash with the balance of the purchase price to be paid pursuant to a note secured by a mortgage on Blue Coal's lands.

13. In 1966 Raymond Colliery had the following wholly-owned subsidiaries: Blue Coal, Gillen Coal Mining, Inc. (Gillen Coal), Carbondale Coal Co., Inc.

(Carbondale), Moffat Premium Anthracite, Inc. (Moffat), Olyphant Premium Anthracite, Inc. (Olyphant Premium) and Gilco, Inc. (Gilco). In addition, Raymond Colliery controlled Minindu Corporation (Minindu) and Glen Nan, Inc. (Glen Nan), which were wholly-owned subsidiaries of Blue Coal, Maple City Coal Co., Inc. (Maple City), Northwest Mining, Inc. (Northwest), Powderly Machine Corp. (Powderly Machine), and Clinton Fuel Sales, Inc. (Clinton), which were wholly-owned subsidiaries of Carbondale, and Powderly Corporation (Powderly) which was owned by Blue Coal and Carbondale.

14. Sometime prior to November 26, 1973, the Gillens and Clevelands incorporated Olyphant Associates, Inc.

(Olyphant) and became Olyphant's sole shareholders. The "Raymond Group" includes Olyphant as well as those corporations

described in the last preceding Finding of Fact.

15. During the period between 1966 and November 26, 1973, Thomas J. Gillen, Jr. and John J. Gillen were the managing officers of the Raymond Group of companies and were members of the Board of Directors of Raymond Colliery.

16. During the period between 1966 and November 26, 1973, Robert W. Cleveland and Royal Cleveland were members of the Board of Directors of Raymond Colliery.

17. During the period between 1966 and November 26, 1973, the Raymond Group was engaged primarily in the business of coal production and the sale of its surplus lands.

18. During the period between 1966 and November 26, 1973, the Raymond Group owned over 30,000 acres of land located

in Luzerne and Lackawanna Counties.

19. Between 1966 and 1973, Blue Coal was either the largest or one of the largest anthracite coal producing companies in the United States.

20. In 1967, the Department of Environmental Resources of the Commonwealth of Pennsylvania (DER) issued an order directing Blue Coal to reduce the pollutants being pumped into public waterways from its deep mine operations or to close such operations.

21. As a result of the DER order, Blue Coal began to phase out its deep mining operations and intensify its conversion to strip mining operations.

22. "Strip mining" is above-ground mining of coal whereby the ground and rock above the coal is stripped off and the coal is removed.

23. Blue Coal incurred substantial

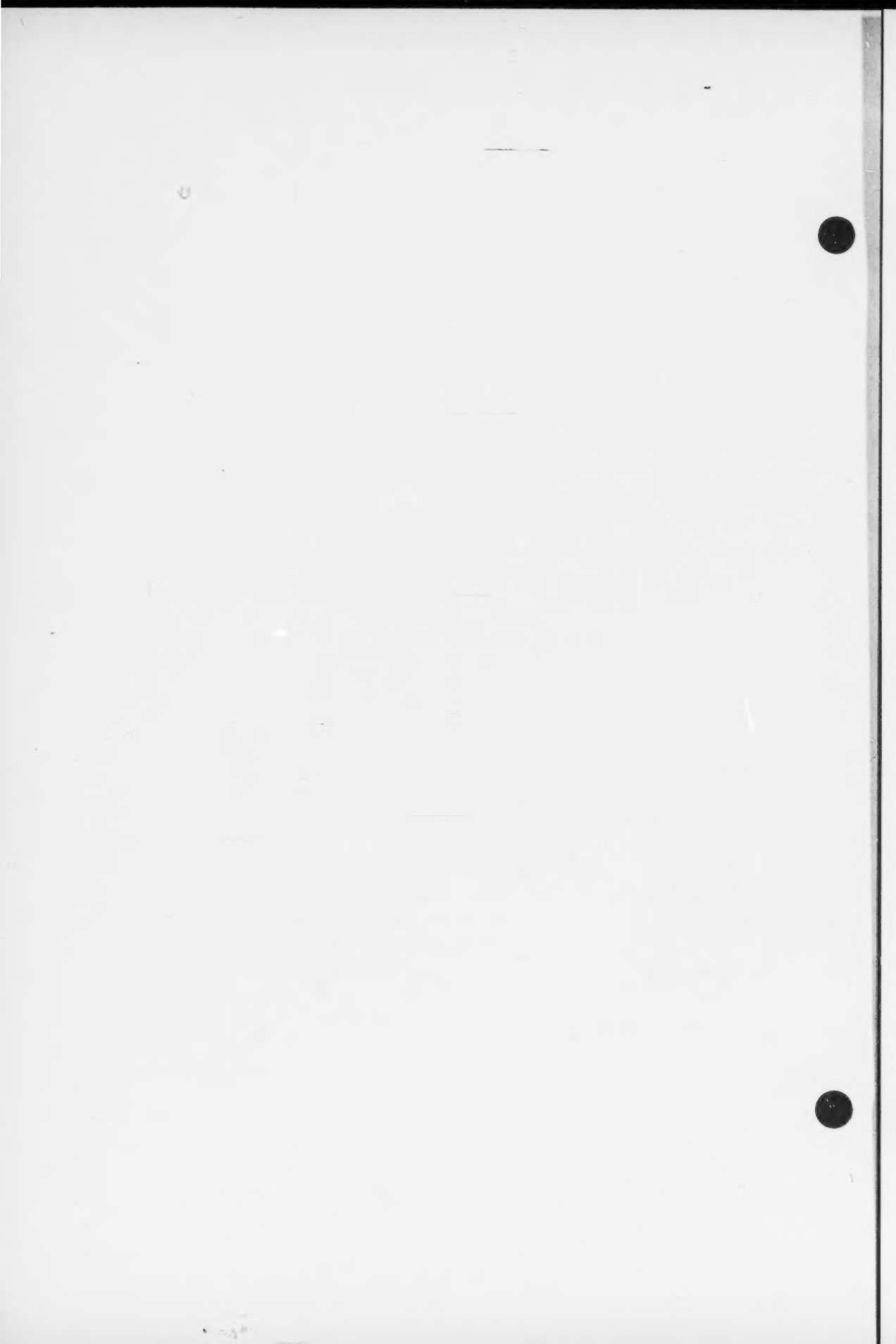


expenses in converting to strip mining because of the cost of new and different equipment required by that process. These expenses depleted the cash reserves of the Raymond Group.

24. In 1971, the Gillens and Clevelands obtained a loan from the Chemical Bank of approximately \$5,000,000 (hereinafter the "Chemical Bank mortgage").

25. The Chemical Bank mortgage was secured by Blue Coal's lands and bore interest at the rate of two points over prime. The mortgage provided that the Chemical Bank receive one-third of the net proceeds from the sales of Blue Coal's surplus lands. The net proceeds were defined as the balance remaining after deduction from the sales price of the costs of sale and expenses required to make the land marketable.

26. The Chemical Bank loan was guar-



98. James Hillary, Vice President and General Counsel of IIT, suggested that the buyers obtain the consent of all actual and incipient creditors of the Raymond Group as a protection for IIT.

99. Hillary's suggestion was not followed in whole or in part.

100. The land release provisions of the proposed Note Purchase and Loan Agreement to be executed by the Raymond Group in conjunction with the IIT loan were re-negotiated so as to provide IIT with a greater share of the land sale proceeds.

101. Hyman Green agreed to guarantee repayment of the first \$1,000,000 of the loan's principal.

102. The closing of the IIT loan was then re-scheduled for November 26, 1973.

103. Between the aborted closing and

November 26, 1973, no significant changes were made to the structure of the transaction.

104. IIT agreed to make the following loans to the companies:

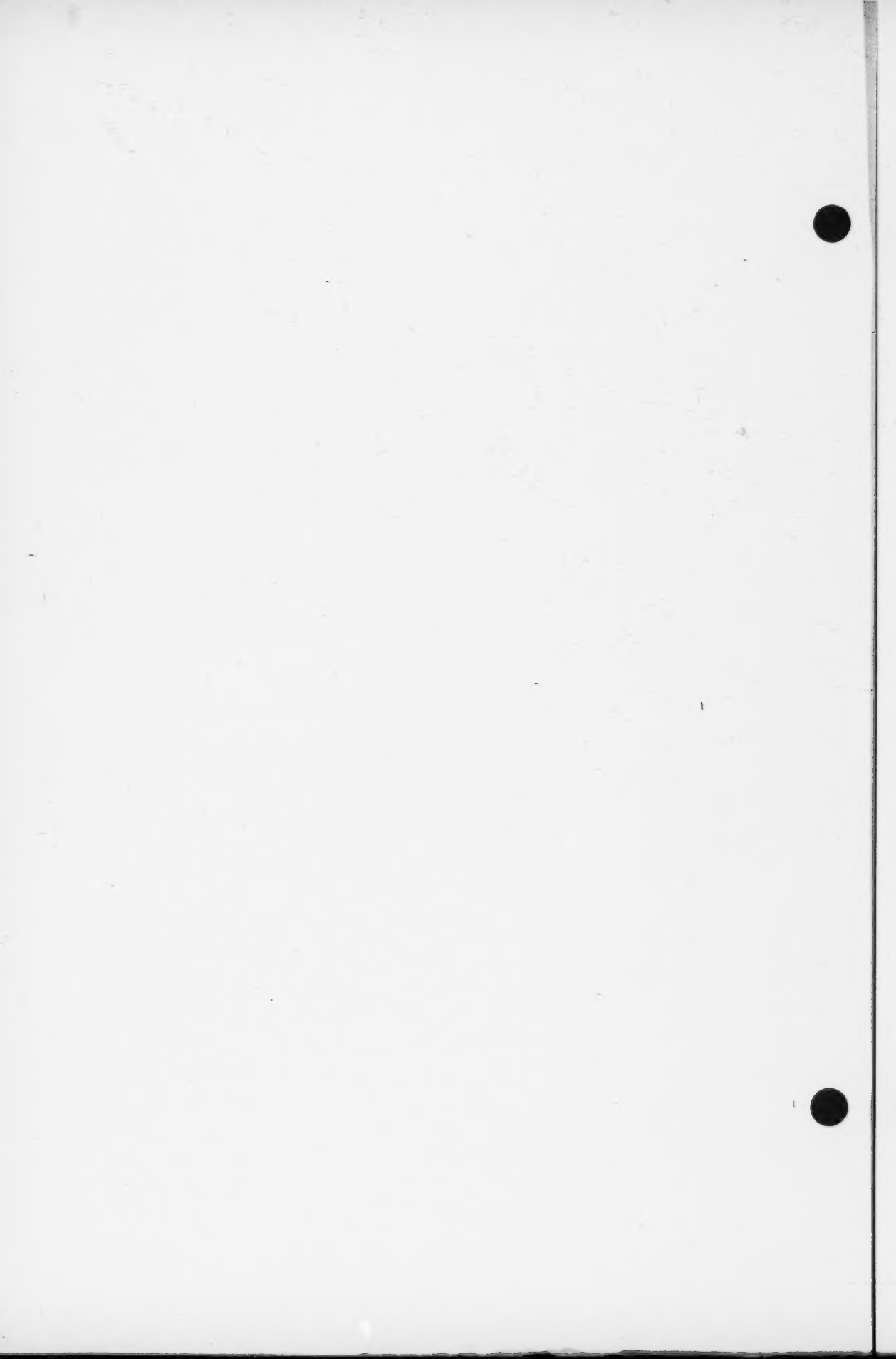
	Direct Loan <u>Proceeds</u>	Total Loan, Inc. Interest <u>Reserve</u>
Raymond Colliery	\$2,590,000	\$3,156,100
Blue Coal	4,270,000	5,203,300
Olyphant	70,000	85,300
Glen Nan	<u>70,000</u>	<u>85,300</u>

Total	7,000,000	8,530,000
-------	-----------	-----------

105. The loans were repayable by December 31, 1976 at an interest rate of five points over prime, but at no less than 12.5%.

106. On November 26, 1973, a Note Purchase and Loan Agreement (the Agreement) was executed by the borrowing companies and IIT.

107. The Agreement provided that each borrowing company create in favor of IIT



a first lien on all its tangible and (24) intangible assets in the amount of the loan to each borrowing company.

108. The Agreement further provided that each borrowing company guarantee the entire \$8,530,000 loan and create in favor of ITT a second lien on all of its tangible and intangible assets as security for the guarantee.

109. The Agreement further provided that each of the affiliated companies, Gillen Coal, Moffat, Northwest, Minindu, Gilco, Maple City, Powderly, Olyphant Premium, Clinton and Carbondale guarantee the entire \$8,530,000 loan and create in favor of IIT a first lien on all its tangible and intangible assets as security for the guarantees. The above companies also agreed to become bound by all provisions and covenants in the Agreement.

110. The IIT loans were also guaranteed by James Durkin, Hyman Green and the Barbara Coal Company, a corporation owned by Durkin.

111. The Raymond Group covenanted under the Agreement that its current assets (defined as the current assets of the Raymond Group as a whole) would never be less than "75% of the sum of (a) Current Liabilities and (b) one year's aggregate rentals under leases" of real and personal property used in the operations of the Raymond Group companies.

112. The consolidated financial statement of the Raymond Group for the six month period ending December 31, 1973, showed current assets of \$3,189,096.21 and current liabilities of \$4,739,612.22.

113. Based on the December 31, 1973 consolidated financial statement of the Raymond Group, the Raymond Group was

technically in default of the foregoing provision of the Agreement from its inception.

114. On or about November 26, 1973, many corporations which were members of the Raymond Group were also technically in default under the working capital and ratio of debt to equity covenants of the Agreement.

115. Under the Agreement, violations of these covenants permitted IIT to accelerate the full amount of the loan as to any borrowing company and immediately collect the aggregate sum from any or all of the borrowing companies and guarantors.

116. The Agreement contained a complex formula for the years 1974 and 1975 under which IIT would release its liens on surplus lands only if portions of the first \$2,500,000 of sales proceeds were



paid over to IIT, Thrift Credit and the Ford Motor Credit Co. in satisfaction of certain obligations owed to each by the borrowers.

117. The operation of the release provisions for 1974 and 1975 would result in a maximum of \$667,500 out of \$2,500,000 in land sales proceeds available for use by the Raymond Group.

118. After payment of income and real estate taxes, if the land sales were taxed by the federal government as ordinary income, the Raymond Group would have a cash loss from the sale of its surplus lands.

119. The Agreement did not provide release provisions for the sale of non-surplus land and equipment owned by the Raymond Group and subject to the IIT lien. Because IIT could refuse to release its liens, IIT had leverage to

determine which unsecured creditors of the Raymond Group would be paid out of the proceeds of the sale of non-surplus land and equipment.

120. All of the mortgages required by the Agreement of the borrowing companies and the affiliated companies were executed by James Durkin as president and recorded in the appropriate offices of Recorders of Deeds.

121. All of the financing statements relating to encumbered personalty required by the Agreement of the borrowing companies and the affiliated companies were executed by James Durkin as president and filed in the appropriate offices of Prothonotaries.

122. In accordance with the requirements of the Agreement, Rosenn, Jenkins and Greenwald, counsel for Durkin, issued an opinion letter dated November 26, 1973

to IIT stating that the Agreement, the notes, the mortgages, and the security agreements given to secure the notes were "valid and binding in accordance with their terms."

123. The Agreement also required an opinion letter satisfactory to IIT, from Morgan, Lewis and Bockius, counsel for IIT.

124. IIT did not waive its right to an opinion letter from Morgan, Lewis and Bockius.

125. Walter M. Strine, Jr., the Morgan, Lewis and Bockius partner representing IIT, declined to provide an opinion letter despite at least one oral and six written requests by IIT to do so.

126. Strine declined to issue an opinion letter because of his concern as to the validity of the mortgages.

127. The \$7,000,000 in direct pro-

ceeds lent by IIT to the borrowing companies was immediately placed in an escrow account established on November 26, 1973 at the United Penn Bank, Wilkes-Barre, Pennsylvania, for the purpose of effecting the closing disbursements.

128. The borrowing companies simultaneously with receipt of the IIT proceeds lent Great American the following amounts:

Blue Coal	\$1,370,000
Raymond Colliery	2,575,000
Olyphant	70,000
Glen Nan	<u>70,000</u>
Total	\$4,085,000

129. Great American issued to each borrowing company an unsecured note promising to repay the loans to the borrowing companies on the same terms and at the same interest rate as pertained to the loans to the borrowing companies from IIT.

130. The loans to Great American by

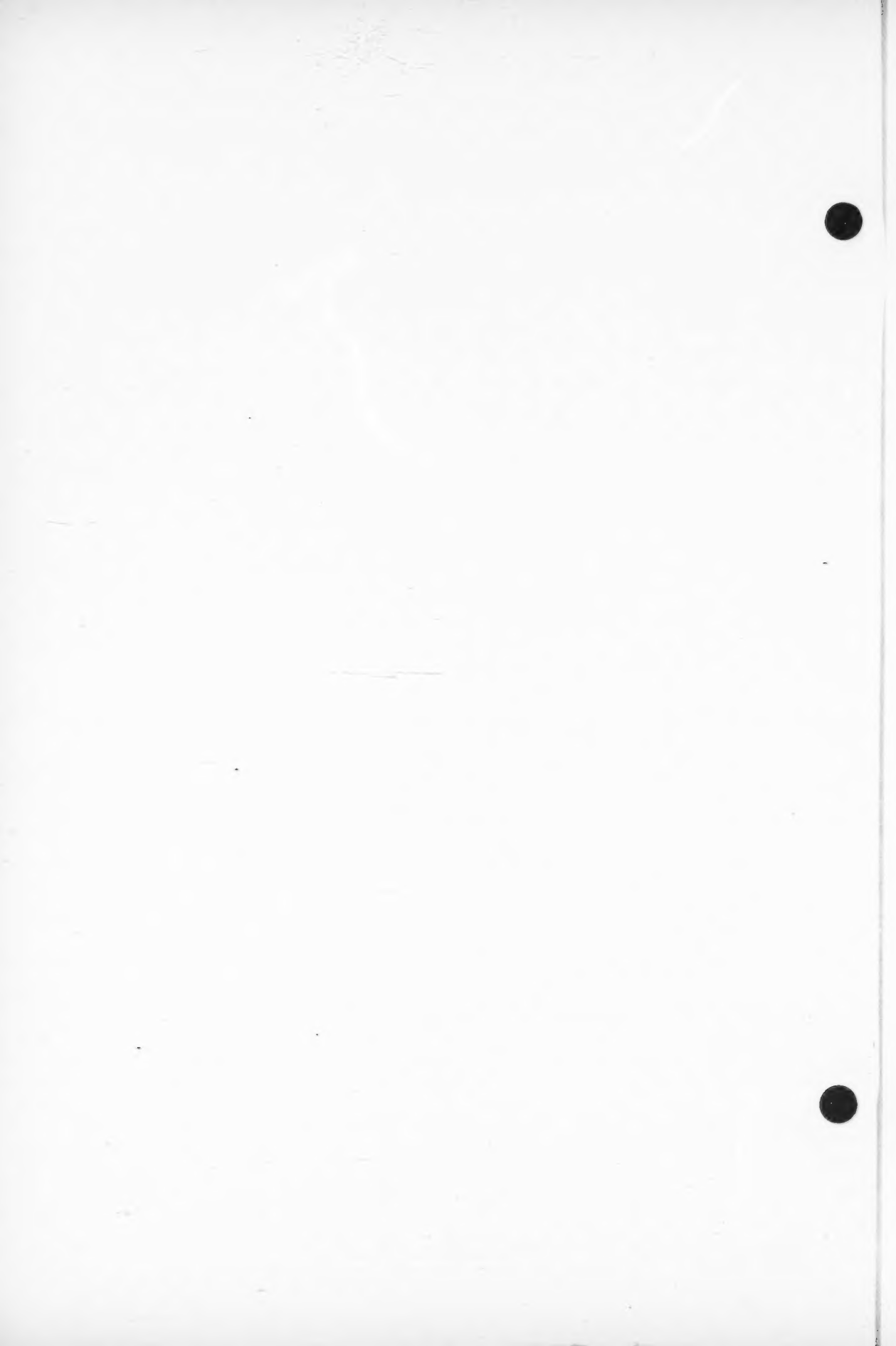
the borrowing companies were applied toward the purchase price of Raymond Colliery's stock.

131. Great American placed approximately \$2,974,501 of its borrowings from others into the escrow account.

132. The escrow account money was paid out as follows:

a. Gillens and Clevelands	\$6,200,000	
b. Gillens and Clevelands	500,000	
c. Bernard Brown for:		
(1) Thomas J. Gillen	190,666	
(2) John Gillen	218,741	
(3) Prior Minor Shareholders	103,333	
(4) Misc. fees	35,750	548,490
d. Rosenn, Jenkins and Greenwald		60,000
e. Parente, Randolph & Co.		20,000
f. Breaker down payment		50,000
g. Judy (coal consultant)		800
h. Taxes		34,337
i. Morgan, Lewis and Bockius		38,632
j. Fried, Frank, Harris, Shriver and Jacobsen		5,375
k. Chemical Bank		2,186,427
l. Glen Alden Co.		315,400
m. James Millard		15,000
Total		<u>\$9,974,501</u>

133. Great American expended the



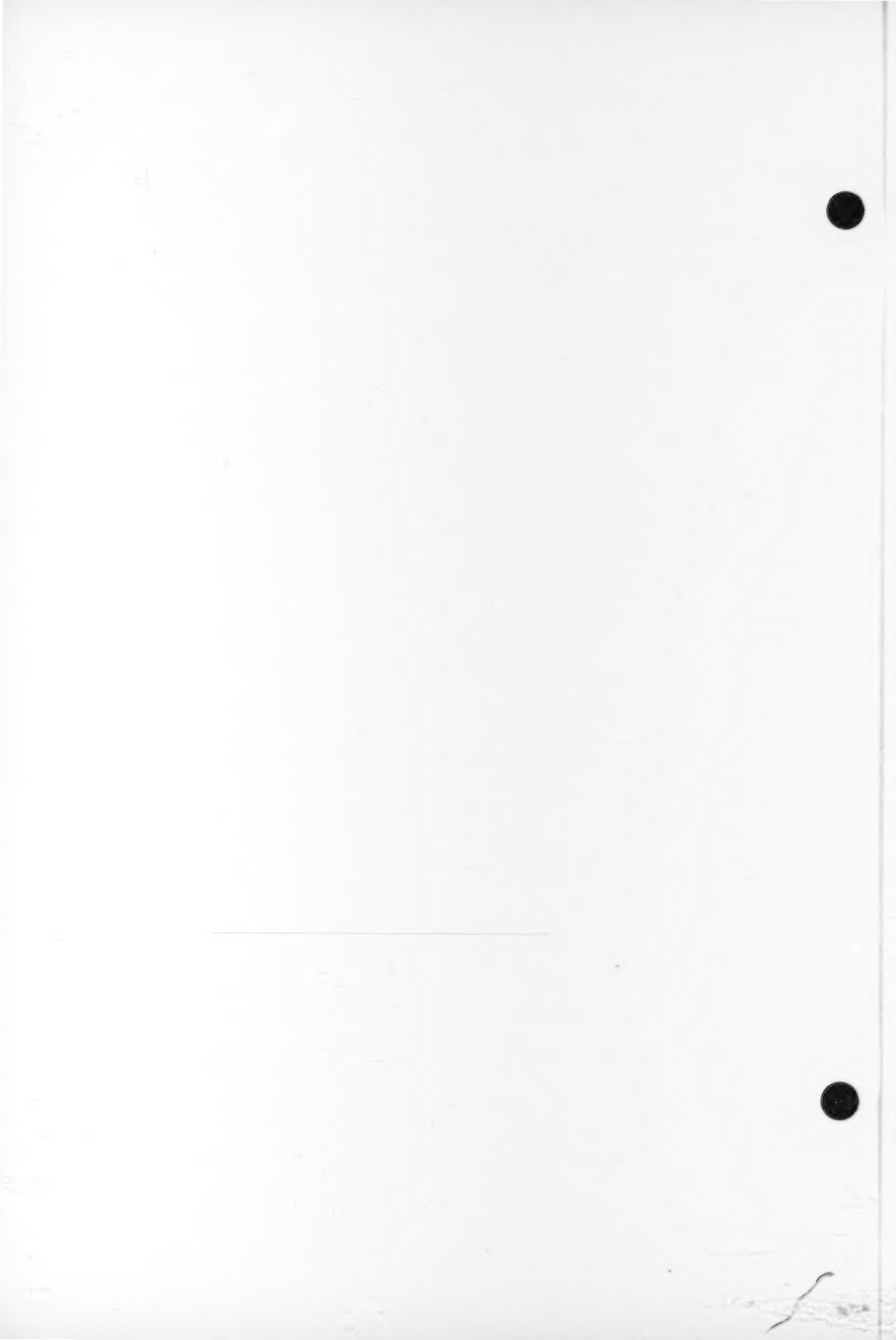
following additional sums in connection with the stock purchase transaction:

Gillens and Clevelands (for the option)	\$500,000
Levinson (broker)	105,000
Title insurance	37,000
Recording costs	2,500
IIT commitment	150,000
IIT fee	20,000
Jackson Associates (Appraisal)	10,000
	<hr/>
	\$825,100

Total

134. The disbursements described in Findings of Fact 132(a) and (b) covered the purchase price paid the Gillens and Clevelands for their Raymond Colliery stock.

135. The purchase price was paid in two separate checks, one for \$6,200,000 and the other for \$500,000. The latter check was endorsed over to Great American by Royal Cleveland on behalf of the selling shareholders as a loan from the Gillens and Clevelands to Raymond Colliery. This loan was evidenced by notes given to



the Gillens and Clevelands in the aggregate sum of \$500,000 by Raymond Colliery. The \$500,000 loan was the result of last minute negotiations at the November 26, 1973 closing which occurred after Durkin realized the closing expenses would leave the Raymond Group with vastly depleted working capital.

136. The monies described in Findings of Fact 132#c)(1)-(4) were paid to Bernard Brown to satisfy purported debts owed by the Raymond Group to its prior shareholders.

137. The expenditures described in Findings of Fact 132(d), (e), (g), (i), (j), and (m) were for professional fees incurred by IIT, Green or Durkin in the process of completing the transaction.

138. The expenditure described in Finding of Fact 132(f) was a down payment on a coal breaker which would allegedly

permit Blue Coal to produce coal more efficiently.

139. The expenditure described in Finding of Fact 132(h) was payment of delinquent real estate taxes owed on the lands of the Raymond Group.

140. The expenditure described in Finding of Fact 132(k) was in satisfaction of the Chemical Bank mortgage owed by Blue Coal and secured by a first lien on its lands.

141. The Gillens and Clevelands required satisfaction of the Chemical Bank mortgage as a condition of the sale of their Raymond Colliery stock at least in part because Royal Cleveland had personally guaranteed repayment of that loan.

142. The expenditure described in Finding of Fact 132(l) was to redeem a pledge in favor of Glen Alden of Raymond

Colliery stock made in 1966 when Raymond Colliery purchased Blue Coal from Glen Alden.

143. Great American covenanted under the Agreement to remain a holding company until the IIT loan was repaid.

144. Great American's sole source of income after November 26, 1973 was dividends which might be declared by Raymond Colliery.

145. The covenants in the Agreement executed by all corporations in the Raymond Group on November 26, 1973 prevented the Raymond Group companies from making "restricted payments" prior to repayment of the IIT loan. "Restricted payments" were defined in the Agreement as "any declaration or payment of any dividend or the making of any distribution, whether in cash, securities, or other property," on any shares of the capital stock of the

borrowing companies or by the guarantor companies.

146. As a result of the above covenants prohibiting dividends, Great American had no source of income until the IIT loan was repaid.

147. Great American, IIT and the Gillens and Clevelands knew Great American had no source of income and would be unable to pay, in accordance with their terms, the notes given the borrowing companies in exchange for the loan to Great American of the IIT loan proceeds.

148. Great American and IIT knew Great American would be unable to pay the \$3,452,000 in loans it obtained from lenders other than IIT in order to finance the stock purchase and that if these loans were to be repaid they would have to be repaid from the sale of assets of the Raymond Group.

149. Great American never made any payment on the notes given the borrowing companies and used the Raymond Group assets in repaying its loans obtained from lenders other than IIT in connection with the purchase of Raymond Colliery's stock.

150. Chicago Title Insurance Co., the insurer of the IIT mortgage, removed from its standard title insurance policy form the exclusion clause which would have given it a defense in the event creditors sought to set aside IIT's mortgages as fraudulent conveyances.

151. The exclusion in the Chicago Title Insurance policy was removed in exchange for a promise by Durkin to indemnify Chicago Title if IIT's mortgages were set aside by creditors as fraudulent conveyances.

152. Attorney Bernard Jacobs, counsel for IIT, would have advised IIT not to

make these loans if Chicago Title Insurance had not removed the above policy exclusion.

153. Durkin, at the request of Jacobs, advised Chicago Title on November 27, 1973 that some of the loan proceeds were to be used to pay the selling stockholders for their stock with the intent to subject Chicago Title to liability if the IIT mortgages were set aside as fraudulent conveyances.

154. The Anthracite Health and Welfare Fund was established sometime prior to 1973 and was intended to provide for the health of coal miners and former coal miners. Coal producers participating in the Fund, including Blue Coal, paid 5 cents to the Fund for each ton of coal produced.

155. On November 26, 1973, the Raymond Group owed the Anthracite Health and



Welfare Fund approximately \$1,033,898.04.

156. On November 26, 1973, the Raymond Group owed the United States government \$2,941,761 in delinquent federal income taxes.

157. The federal income taxes owed by the Raymond Group on November 26, 1973, consisted of taxes, penalties and interest for fiscal years ending June 30, 1966, June 30, 1967, June 30, 1968, June 30, 1969, June 30, 1971, June 30, 1972 and June 30, 1973.

158. On November 26, 1973, the Raymond Group owed approximately \$1,368,376 in real estate taxes to Lackawanna and Luzerne Counties.

159. On November 26, 1973, the Raymond Group owed \$1,146,180 to the Commonwealth of Pennsylvania for backfilling obligations.



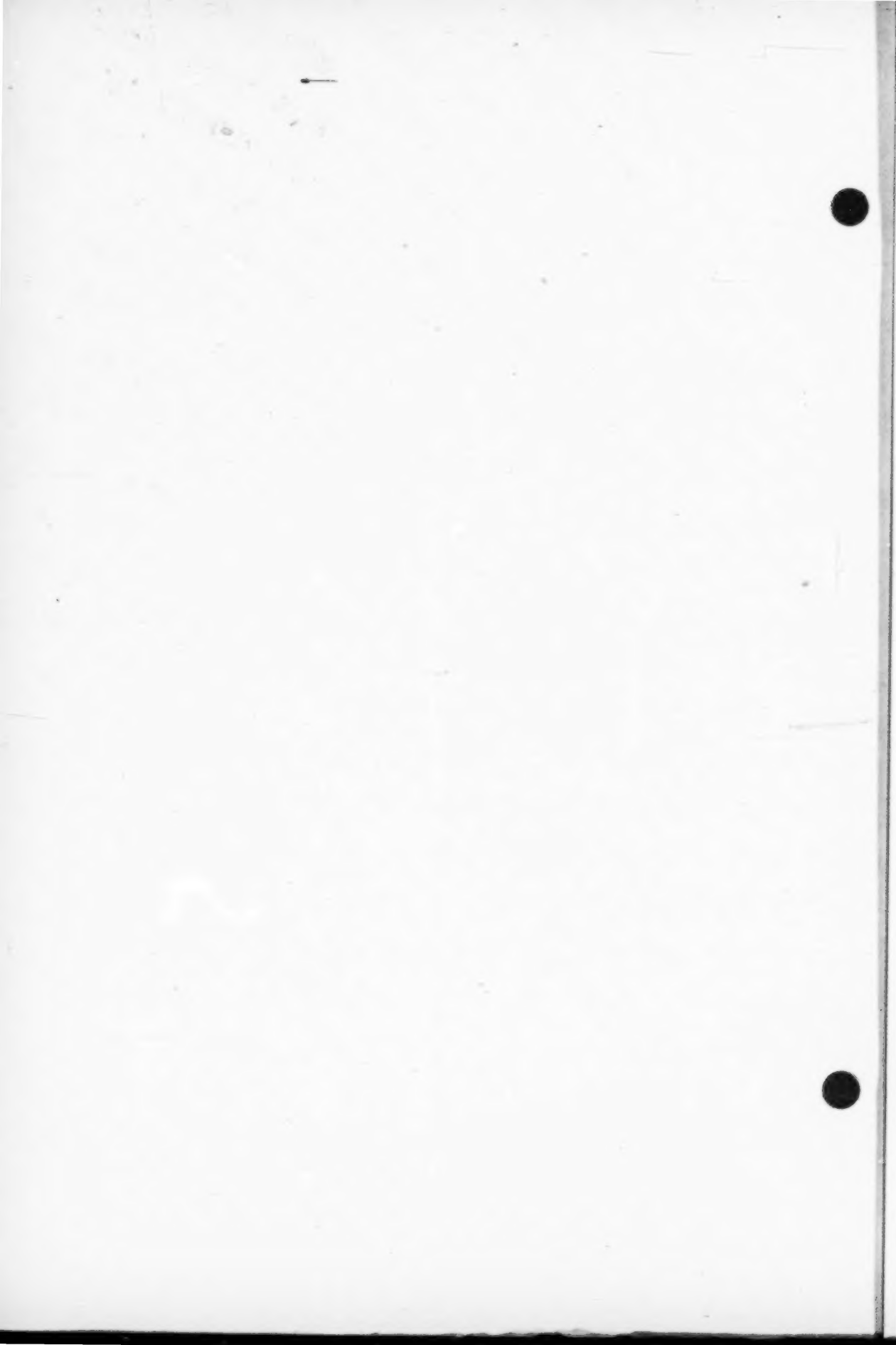
160. On November 26, 1973, the Raymond Group owned approximately \$2,293,250 to miscellaneous creditors.

161. After November 26, 1973, the Raymond Group lacked the funds to pay its routine expenses including those for materials, supplies, telephone and electricity, and was forced to generate cash towards the payment thereof by liquidating its mining equipment.

162. Within two months after the November 26, 1983 closing, the deep coal mining operations of Blue Coal were shut down.

163. The Gillens and Clevelands knew the deep mines were flooded and were no longer economically feasible to operate. They did not share this knowledge with IIT or Durkin.

164. Within six months after the November 26, 1973 closing, the Raymond



Group had ceased substantially all of its strip mining operations.

165. After the Raymond Group terminated its mining operations the Raymond Group was sued for breach of a contract to sell coal because it could no longer supply the coal promised in the contract.

166. The plaintiff in the action mentioned in the preceding paragraph also refused to pay accounts owed the Raymond Group, claiming that the amounts due were set off by the damages owed by the Raymond Group for breach of contract.

167. Within seven months after the November 26, 1973 transaction, the Raymond Group was subjected to a series of injunctions for its failure to perform the backfilling of its strip mines required under Pennsylvania law and failure to pay obligations to the Anthracite Health and Welfare Fund. These injunc-

tions prevented the Raymond Group from moving or selling its equipment until the obligations were satisfied.

III. Discussion.

A. Overview.

The United States seeks to set aside as fraudulent conveyances the mortgages given to IIT by the borrowing companies to secure the IIT loans. The United States also seeks to set aside as fraudulent conveyances the mortgages given to IIT by all companies in the Raymond Group to secure their guarantees of the aggregate \$8,530,000 in loans made by IIT. In his crossclaim, the Trustee, as the representative of the creditors of the bankrupt corporations, seeks relief from the mortgages and guarantee mortgages encumbering the lands of Blue Coal and Glen Nanwhich is identical to that sought by the United States. Hereinafter, the



United States and the Trustee will collectively be referred to as "the Creditors". Specifically, the creditors allege that the mortgages and guarantee mortgages are fraudulent conveyances under

Sections 354, 355, 356, and 357 of the Pennsylvania Fraudulent Conveyances Act Uniform (hereinafter "the Act"), 39 Pa.-Cons.Stat. Sec.351 et seq. The decisions of Pennsylvania courts under the Act control. *Commissioner vs. Stern*, 357 U.S. 39, 45 (1958). Where no Pennsylvania case law exists on certain points, we have interpreted the language of the Act using the case law developed under the Uniform Fraudulent Conveyances Act in other jurisdictions. See Pa.Cons.Stat. Sec.362.

Sections 354 and 355 of the Act are commonly referred to as constructive fraud provisions because under each of

these two sections the intent and knowledge of the transferor and transferee are not in issue. Farmers Trust Co. of Lancaster vs. Bevis, 331 Pa. 89, 200 A. 54 (1938). Under Section 354, "every conveyance made and every obligation incurred by a person who is or will be thereby rendered insolvent, is fraudulent as to creditors...if the conveyance is made or the obligation is incurred without a fair consideration." Pa.Cons.Stat. Sec.354. Under Section 355, any -"conveyance made without fair consideration, when the person making it is engaged, or about to engage, in a business or transaction for which the property remaining in his hands after the conveyance is an unreasonably small capital, is fraudulent as to creditors...." The constructive fraud provisions of the Act require a creditor seeking to set aside a con-

veyance as fraudulent to show lack of fair consideration, insolvency or undercapitalization. First Nat'l Bank of Marietta vs. Hoffines, 429 Pa. 109, 114-15, 239 A.2d 458 (1968). Under the Act's constructive fraud provisions, a conveyance will not be set aside as fraudulent if it was made for fair consideration. If the transfer was not made for fair consideration, then, depending upon the financial condition of the transferor at or immediately after the time of transfer, the transfer may be fraudulent. We will consider the application of the constructive fraud provisions of the Act to the challenged mortgages and guarantee mortgages by first determining whether the Raymond Group received fair consideration in exchange for the mortgages. After reaching the fair consideration issue, we will examine the financial

condition of the Raymond Group on or about November 26, 1973.

Sections 356 and 357 of the Act are commonly referred to as the Act's intentional fraud provisions. Under Section 356, any conveyance made without fair consideration by one who intends or believes he will incur debts beyond his ability to repay is fraudulent. Under Section 357, any obligation incurred or conveyance made with the intent to hinder, delay, or defraud creditors is fraudulent. Under Section 357, the only inquiry is whether the requisite fraudulent intent existed at the time of the conveyance and whether creditors were in fact prejudiced by the conveyance. Queen-Favorite Bldg. & Loan Ass'n. vs. Burstein, 310 Pa. 219, 165 A. 13 (1933). See also United States vs. Johnston, 245 F.Supp. 433, 440 (W.D. Ark. 1965). The

application of these two provisions of the Act to the conveyances challenged herein will be discussed in Section D of this opinion.

Finally, we will address the Creditors' arguments regarding the liability of the Gillens and Clevelands and the Creditors' claim that the mortgages are void as illegal and ultra vires acts under Pennsylvania law.

B. Fair Consideration.

Fair consideration is defined in Section 353 of the Act as follows:

Fair consideration is given for property or obligation:

(a) When, in exchange for such property or obligation, as a fair equivalent therefor and in good faith, property is conveyed or antecedent debt is satisfied; or

(b) When such property or obligation is received in good faith to secure a present advance or antecedent debt in amount not disproportionately small as compared with the value of

the property or obligation obtained.
39 Pa.Cons.Stat. #353.

Section 353(a) of the Act is the test of fair consideration against which the consideration received by the Raymond Group in exchange for the obligation to IIT must be measured. The Note Purchase and Loan Agreement requiring the Group to pay IIT \$8,530,000 is the obligation given in exchange for the loan proceeds and the obligation to repay the IIT loans must be a "fair equivalent" of the loan proceeds obtained by the Raymond Group.

The initial question under Section 353(a) is whether the transferee, IIT, transferred its loan proceeds in good faith. See Cohen vs. Southerland, 257 F.2d 737 (2d Cir. 1958); Inland Security Co., Inc. vs. Estate of Kirshner, 382 F.Supp. 338 (W.D. Mo. 1974). IIT knew or strongly suspected that the imposition of



the loan obligations secured by the mortgages and guarantee mortgages would probably render insolvent both the Raymond Group and each individual member thereof. In addition, IIT was fully aware that no individual member of the Raymond Group would receive fair consideration within the meaning of the Act in exchange for the loan obligations to IIT. Thus, we conclude that IIT does not meet the standard of good faith under Section 353(a) of the Act. See e.g., Cohen vs. Southerland, 257 F.2d at 742 (transferee's knowledge that the transferor is insolvent defeats assertion of good faith); Epstein vs. Goldstein, 107 F.2d 755, 757 (2d Cir. 1939) (transferee's knowledge that no consideration was received by transferor relevant to the issue of good faith).

The second question to be resolved under Section 353(a) is whether the obli-



gation received by IIT was the fair equivalent of the loans to the borrowing companies. (Parenthetically, we note that the Creditors seek to set aside the conveyance of the mortgages and guarantee mortgages which served as collateral for the loan obligations and not the obligations themselves. However, we will examine whether the obligations were supported by fair consideration. If not, the mortgages to secure the same were also not supported by fair consideration.)

The obligation received by IIT was in the amount of \$8,530,000. Defendants argue that in exchange for this obligation, the borrowing companies received a loan collectively totalling \$7,000,000 and that this amount was a fair equivalent of the \$8,530,000 aggregate loan principal they agreed to repay. Defendants further argue that there was

in fact no disparity in amount between the obligations incurred and the benefits received because the \$1,530,000 difference between the proceeds received by the borrowing companies and the amount owed IIT was placed in an interest reserve and would be applied to the interest as it accrued on the loans.

The borrowing companies appeared to receive fair consideration within the meaning of Section 353(a) of the Act despite the disparity between the obligations incurred and the actual proceeds received. See e.g., People-Pittsburgh Trust Co. vs. Holy Family Polish National Church, 341 Pa. 390, 393, 19 A.2d 360 (1941). However, the issue of whether fair consideration was received by the Raymond Group must be examined from the point of view of the Raymond Group's creditors. Larrimer vs. Feeney, 411 Pa.

604, 609.192 A.2d 351 (1963). As IIT's attorneys structured the loan transaction, an escrow account was created into which the IIT loan proceeds were deposited. Very large portions of the loan proceeds were then lent by the borrowing companies to Great American. In exchange for the loans to Great American, each borrowing company received an unsecured promissory note from Great American in which Great American promised to repay the loans in accordance with the same terms and conditions under which the borrowing companies were to repay the loans to IIT (i.e. interest at 5 points over the prime rate and repayment of the principal within three years).

The Defendants argue that the Great American notes executed in favor of each borrowing company were valuable assets each borrowing company purchased with the

IIT loan proceeds. This argument is specious because all parties to the IIT loan knew as of November 26, 1973 that the Great American notes would not and could not be paid in accordance with their terms. Indeed, no payment was ever made to the borrowing companies on the Great American notes. Great American was solely a holding company which owned the stock of Raymond Colliery and Olyphant. Under the Agreement with IIT, Great American covenanted to remain a holding company until the IIT loans were paid off. The only sources of income to Great American were the sale of Raymond Colliery or Olyphant stock which Great American had covenanted under the Agreement not to sell or the receipt of dividends from Raymond Colliery or Olyphant which Raymond Colliery and Olyphant had covenanted under the Agreement not to declare.

Because Great American could not and in fact did not repay the notes to the borrowing companies in accordance with their terms, these notes cannot be considered as valuable assets obtained by the borrowing companies from the IIT loan proceeds. The \$4,085,000 in IIT loan proceeds which were lent immediately by the borrowing companies to Great American were merely passed through the borrowers to Great American and ultimately to the selling stockholders and cannot be deemed consideration received by the borrowing companies.

Raymond Colliery received \$2,590,000 in loan proceeds from IIT and immediately and as part of the overall transaction lent \$2,575,500 to Great American. Approximately \$14,400 of the remaining funds were used by Raymond Colliery to pay delinquent real estate taxes. While

the \$14,400 was a genuine benefit to Raymond Colliery, it was one that was not a fair equivalent of the \$3,156,100 loan obligation to IIT undertaken by Raymond Colliery.

Blue Coal received \$4,270,000 in loan proceeds from IIT and immediately and as part of the overall transaction lent \$1,370,000 to Great American. Because Blue Coal was left with \$2,522,527 in IIT loan proceeds which it applied in satisfaction of antecedent debts, the Defendants argue that the benefit received by Blue Coal was a fair equivalent of the obligation it undertook to repay IIT \$5,203,300. Of the \$2,522,527 in IIT loan proceeds retained by Blue Coal after the loan to Great American, \$2,186,427 was used to satisfy a Chemical Bank mortgage owed by Blue Coal and secured by a first lien on its lands, \$20,000 was used

to pay delinquent real estate taxes, \$315,000 was used to redeem a pledge to Glen Alden of Blue Coal stock and \$100 was used to pay unspecified "fees." .

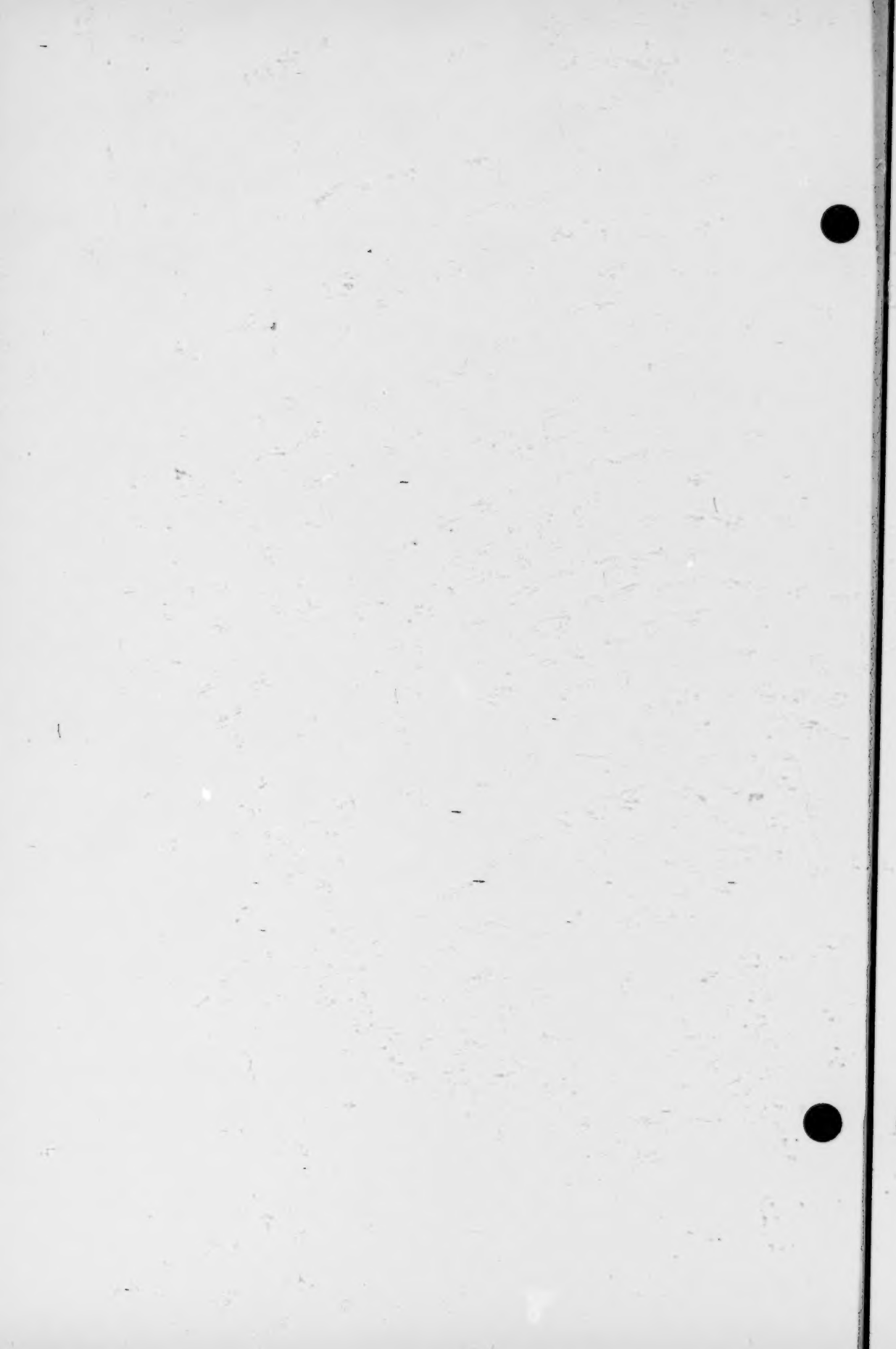
The United States disputes the conclusion that all of these expenditures inured to the benefit of Blue Coal. Even assuming that both the satisfaction of the Chemical Bank mortgage and the other payments in fact inured to the benefit of Blue Coal, we are of the opinion that taken as a whole the benefit received by Blue Coal was not a fair equivalent of the obligation it gave to IIT. Thus, Blue Coal did not receive fair consideration from IIT.

Finally, Glen Nan and Olyphant each received \$70,000 in loan proceeds from IIT and each lent the entire amount to Great American. As the Great American notes cannot be considered any real bene-

fit to Glen Nan or Olyphant, neither received fair consideration in exchange for the obligations to IIT.

Defendants argue that the Raymond Group in fact had the benefit of all the IIT proceeds because those proceeds lent to Great American were used to benefit the Raymond Group. Great American applied the \$4,085,500 of IIT loan proceeds it received as loans from the borrowing companies towards the purchase of Raymond Colliery's stock. The \$4,085,500 was commingled in the escrow account with \$3,633,837 in other funds. Several contemporary writings by persons involved in the transaction show that these funds were used by Durkin to purchase Raymond Colliery's stock. Thus, we conclude that the entire amount of \$4,085,500 was applied towards the purchase price of Raymond Colliery's stock.

Defendants suggest that the use of the proceeds to purchase Raymond Collier's stock was a benefit to the borrowing companies because it resulted in their obtaining new management. We are of the opinion that new management does not fall within the definition of fair consideration in the Act. Because of the comparisons required under both Sections 353(a) and 353(b) we believe that the drafters thereof intended consideration to mean only consideration with a monetary value. We also have not found any authority in any jurisdiction to support the argument that new management can be considered fair consideration under the Uniform Fraudulent Conveyances Act. Additionally, even assuming new management may constitute fair consideration, it clearly cannot be so considered in this case. The new management received



by the borrowing companies consisted of James and Anna Jean Durkin and Hyman Green. None of these individuals had experience in managing large coal operations and large-scale sales of real estate and in fact operated these companies with disastrous results. The new management was not sufficiently valuable consideration so as to sustain the loans. We note the argument of the United States that, even assuming fair consideration was received by the Raymond Group under Section 353(a), the conveyances by the Raymond Group of encumbrances to secure the IIT obligation were not supported by fair consideration within the meaning of Section 353(b). IIT encumbered all assets of the Raymond Group to secure its loans and the guarantees thereof and the United States argues that the value of the encumbered assets was grossly in

excess of the present advance. See Commonwealth Trust Co. vs. Reconstruction Fin. Corp., 120 F.2d 254 (3d Cir.1941). Because we find that the obligation received by IIT was not supported by fair consideration under Section 353(a) of the Act, we need not reach the question of whether the conveyances by the Raymond Group of encumbrances to secure the loan were supported by fair consideration under Section 353(b).

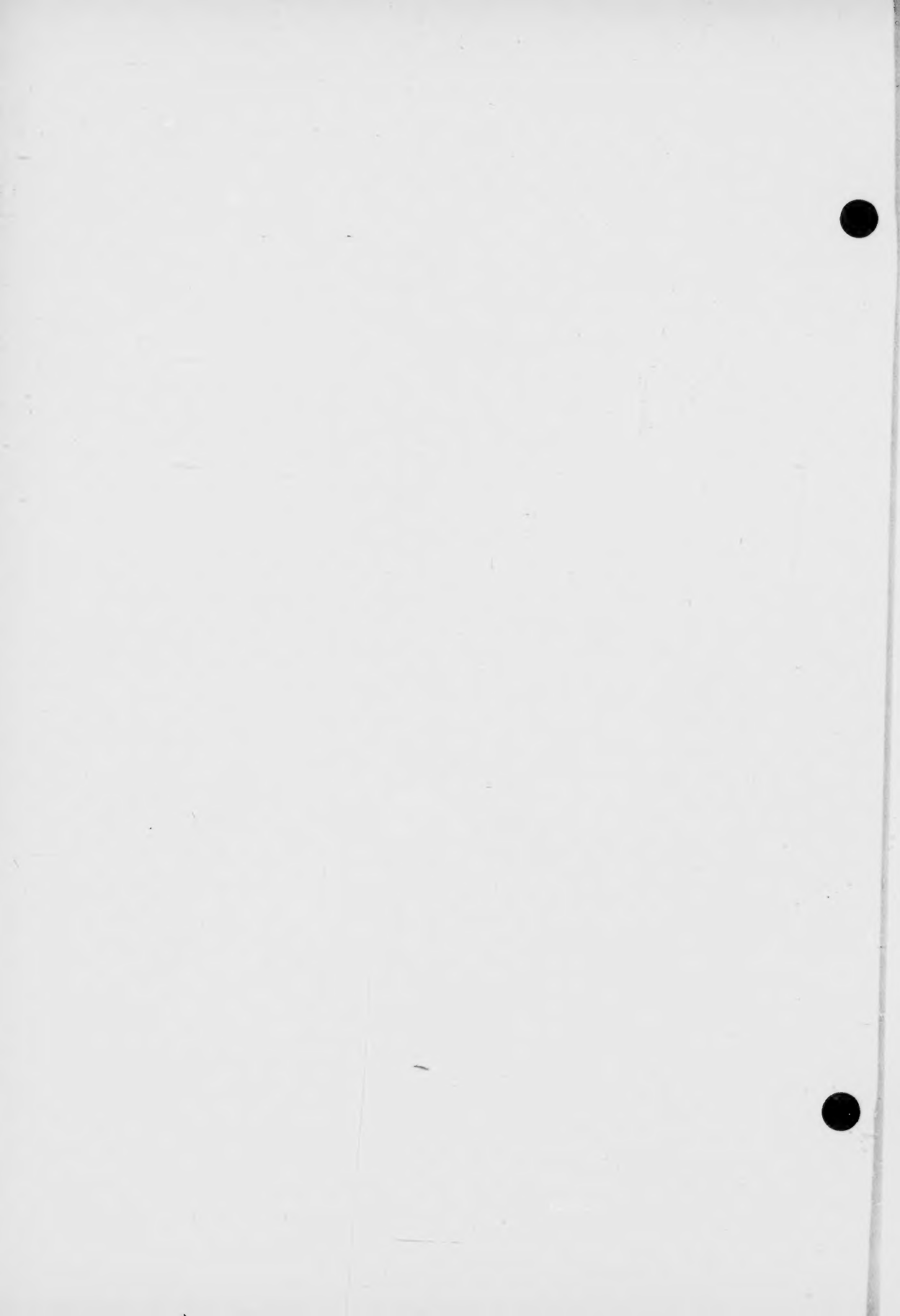
An additional question which must be addressed is whether IIT gave fair consideration to those companies which executed guarantee mortgages for the full amount of the IIT loans. The borrowing companies were primarily liable on the notes and loans by IIT. As we have already determined, the borrowing companies did not receive fair consideration in exchange for the IIT loan obligations.

They received no additional consideration for the guarantee mortgages. Therefore, the borrowing companies did not receive fair consideration in exchange for the guarantees they executed with respect to the aggregate amount of the IIT loan of \$8,530,000.

Those guarantors of the IIT loans who were not borrowing companies were, in essence, only secondarily liable on the IIT notes and loans. Nonetheless, despite the contingent nature of their obligations, the guarantees are clearly "obligations incurred" under the Act, see Zellerback Paper Co. vs. Valley Nat'l. Bank, 13 Ariz..App. 431, 477 P.2d 550 (1970); Roxbury State Bank vs. The Clarendon, 129 N.J. Super. 358, 324 A.2d 24, cert. denied. 66 N.J. 316, 331 A.2d 16 (1974), and the mortgages collateralizing the guarantees are clearly conveyances

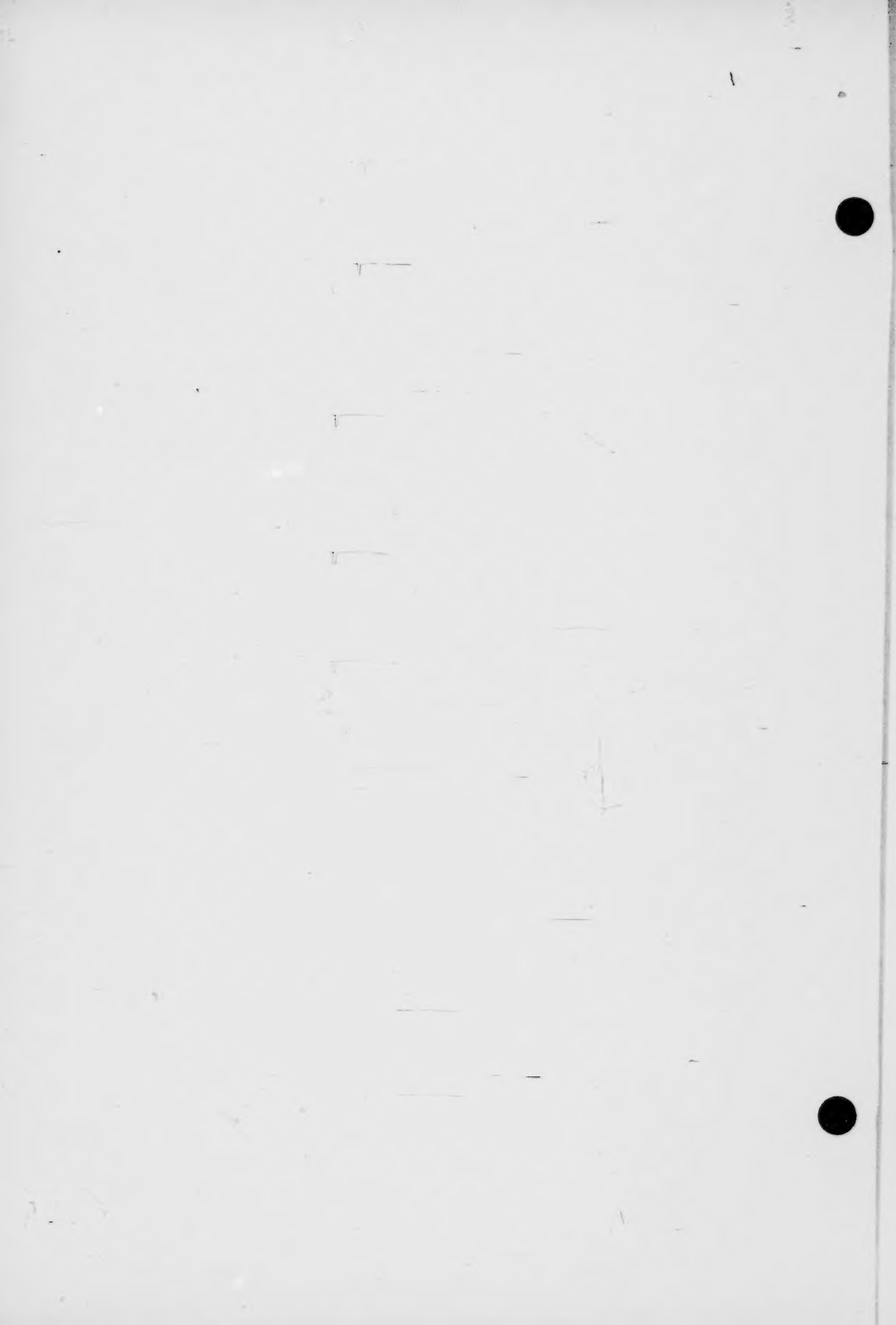


under the Act. 39 Pa.Cons.Stat. Sec. 351. No consideration at all flowed to the guarantors who were not borrowing companies. Indeed, no Defendant has advanced even a colorable argument that any guarantor received any valuable consideration. The only conceivable benefit these guarantors could have received in exchange for their guarantee mortgages was the closing of the IIT loan to the borrowing companies. The IIT loan resulted in new management for the guarantors and certain related theoretical indirect benefits. As discussed earlier, new management cannot be considered an element of fair consideration under the Act. Additionally, as to those guarantors who were not also borrowing companies, there is absolutely no evidence that they received any direct or indirect benefit at all from the loans to the borrowing com-



panies. None of the loan proceeds trickled down to the guarantors. In addition, receipt of the the IIT loan proceeds did not strengthen the financial position of the guarantors' parent corporations. Thus the guarantors received no benefit under a theory that the execution of the guarantees inducing IIT to make the loans to the borrowers benefited the guarantors by strengthening the financial position of the Raymond Group as a whole. We therefore conclude that the benefit received by the guarantors was not a fair equivalent of the obligation incurred to IIT.

For the above reasons, we find that the obligations incurred by the Raymond Group and its individual members to IIT were not supported by fair consideration. The mortgages and guarantee mortgages to secure these obligations were also not



supported by fair consideration.

C. The Financial Condition of the Raymond Group.

The second issue to be considered under the constructive fraud provisions of the Act relates to the financial condition of the transferor at the time of and immediately after the challenged conveyance was made or obligation incurred.

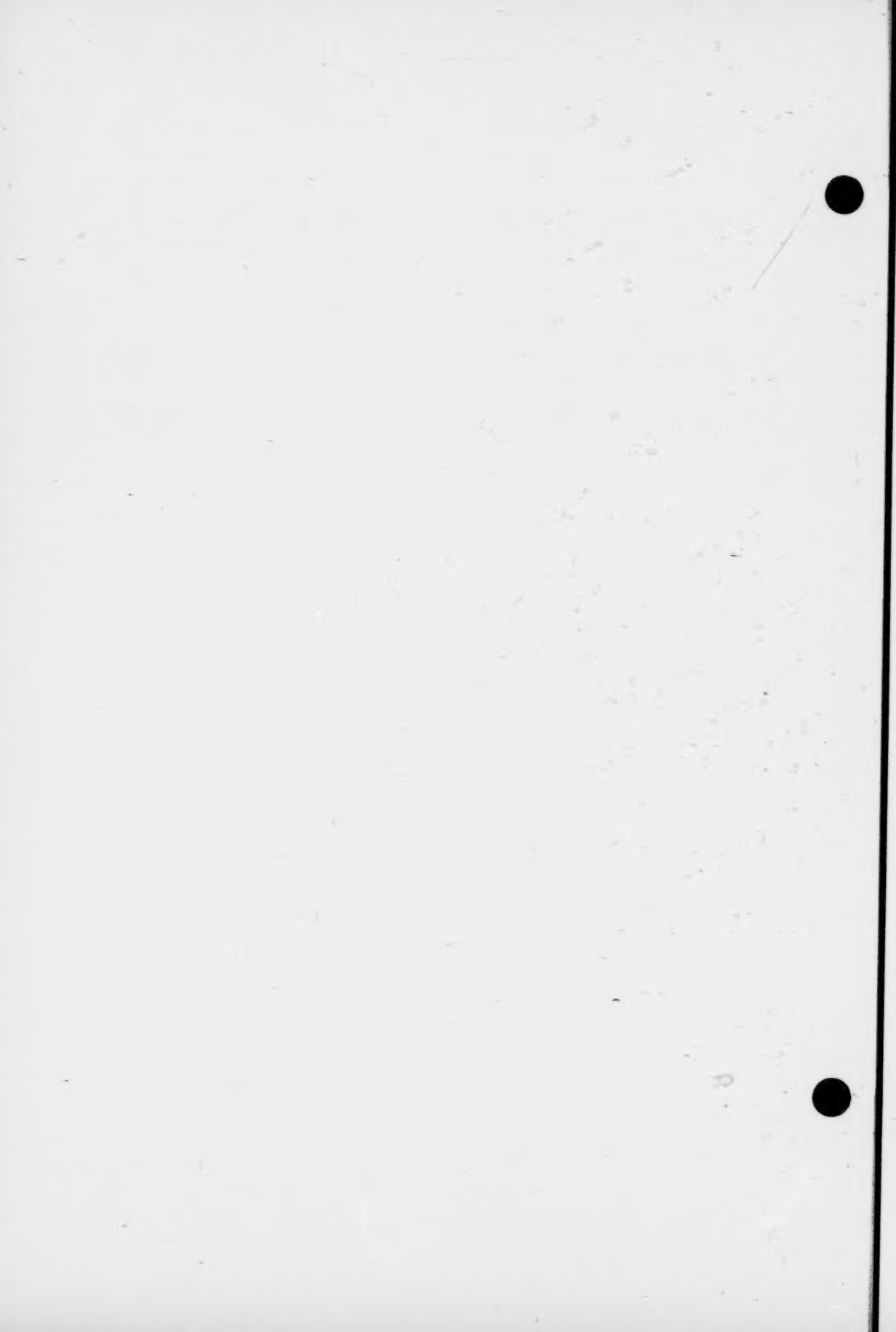
Each constructive fraud provision of the Act requires a different showing as to the financial condition of the transferor before a conveyance will be set aside. Section 354 requires an inquiry into whether the transferor was insolvent at the time the obligation was incurred or conveyance made or was rendered insolvent thereby. Section 355 requires an inquiry as to whether the property remaining in the transferor's possession

after the conveyance was an unreasonably small amount of capital for the business in which it was engaged.

There is a dispute between the Creditors and the Defendants as to who has the burden of proof on the issue of the solvency of the Raymond Group. The Creditors argue that the burden of proof on this issue shifted to the Defendants once it was shown a conveyance was made by one having debts. First, Nat'l Bank of Marietta vs. Hoffines, 429 Pa. 109, 114, 239 A.2d 458 (1968). Defendants argue that the burden of proof would only shift to them under Pennsylvania law if the conveyance being challenged involved a transfer between related parties. Our review of Pennsylvania law indicates that once a creditor shows a conveyance was made or an obligation incurred without fair consideration by one in debt, the duty

shifts to the transferee or obligee to prove the debtor was solvent. Baker vs. Geist, 457 Pa. 73, 321 A.2d 634 (1974); Farmers Trust Co. vs. Bevis, 331 Pa. 89, 200 A. 54 (1938). While the burden of proof on the issue of solvency rested with the Defendants, we are of the view that, even had the burden been on the Creditors, that burden would have been more than amply met by the evidence presented by the United States.

One other preliminary matter relates to whether the solvency of the Raymond Group should be determined by examining the Raymond Group as a whole or by examining the individual members thereof. Because the business of the Raymond Group was conducted as though the Raymond Group was a single entity and because the Defendants urged the Court not to look at the solvency of individual Raymond Group



members, e.g., 68 Trial Transcript 42, we will deal only with the financial position of the Raymond Group as a whole and not in terms of its individual parts.

The question is whether the Raymond Group was solvent on November 26, 1973 immediately before the transaction and immediately thereafter. *Angier vs. Warrell*, 346 Pa. 450, 31 A.2d 87 (1943). The Act defines solvency as follows:

A person is insolvent when the present, fair, salable value of his assets is less than the amount that will be required to pay his probable liability on his existing debts as they become absolute and matured.

39 Pa.Cons.Stat.Sec. 352(1).

"Debts" are defined under the Act as "any legal liability whether matured or unmatured, liquidated or unliquidated, absolute, fixed, or contingent." 39 Pa. Cons. Stat. Sec. 351. The "assets" of a



debtor include all property not exempt from liability for his debts. 39 Pa. Cons. Stat. Sec. 351. Because the debtors in this case are corporations, none of their property was exempt from liability for their debts under bankruptcy or other law. Therefore, all assets of the Raymond Group are to be considered in determining whether or not it was solvent on November 26, 1973 or immediately thereafter.

In assessing the solvency of the Raymond Group, all of its existing debts must be considered. This includes not only those debts which were absolute and matured on November 26, 1973, but also those debts which were liabilities on November 26, whether "matured or unmatured, liquidated or unliquidated, absolute, fixed or contingent." 39 Pa. Cons. Stat. Sec. 351. See Baker vs.

Geist, 457 Pa. 73, 321 A.2d 634 (1974); Continental Bank vs. Marcus, 242 Pa. Super. 371, 363 A.2d 1318 (1976).

The debts of the Raymond Group that were matured on November 26, 1973 totalled in excess of \$8,700,000. In addition, the Group had an \$8,530,000 obligation to IIT. Further, Great American borrowed \$3,500,000 from lenders other than IIT to finance its purchase of Raymond Colliery's stock. Great American had no source of income and intended to use the assets of the Raymond Group to pay the interest and principal on the above loans. These debts therefore constitute an obligation of the Raymond Group. Based on the above, we conclude that the Raymond Group had existing debts of at least \$20,000,000 on November 26, 1973.

These debts of the Raymond Group are to be compared to the "present, fair,

salable value" of the Raymond Group's assets. 39 Pa.Cons.Stat. Sec. 362. The phrase means that value which can be obtained if the assets are liquidated with reasonable promptness in an arms-length transaction in an existing and not theoretical market.

This meaning of the phrase "present, fair, salable value" is in accord with the interpretation given thereto by the Pennsylvania Supreme Court in Larrimar vs. Feeney, 411 Pa. 604, 192 A.2d 351 (1963), wherein it stated:

A reasonable construction of the ...statutory definition of insolvency indicates that it not only encompasses insolvency in the bankruptcy sense, i.e., a deficit net worth, but also includes a condition wherein a debtor has insufficient presently salable assets to pay existing debts as they mature. If a debtor has a deficit net worth, then the present salable value of his assets must be less than the amount required to pay the liability on his

debts as they mature. A debtor may have substantial paper net worth including assets which have a small salable value, but which if held to a subsequent date could have a much higher salable value. Nevertheless, if the present salable value of his assets are [sic] less than the amount required to pay existing debts as they mature, the debtor is insolvent.

Larrimar vs. Feeney, 411 Pa. at 608, 192 A.2d at 197 (emphasis in the original, citation omitted).

Pennsylvania state courts and federal courts have consistently taken the position that the test of solvency under the Act is the present ability to pay one's debts as they mature, see United States vs. St. Mary, 334 F.Supp. 799, 802 (E.D. Pa. 1971), and a debtor will not be considered solvent under the Act merely because he is still able to trade on credit or has assets with a fair market value which would permit him to pay his

debts at some future time upon a liquidation of his business. Larrimar vs. Feeney, 411 Pa. at 608, 192 A.2d at 197; Fidelity Trust Co. vs. Union Bank, 313 Pa. 467, 475, 169 A. 209 (1933), cert. denied, 291 U.S. 680 (1934) (error to consider fair salable value instead of present fair salable value-- "present" may not be disregarded). See also In re Franklin Nat. Bank Securities Litigation, 2 B.R. 687, (E.D. N.Y. 1979), aff'd, 633 F.2d 203 (2d Cir. 1980); Glenmore Distilleries Co. vs. Seideman, 267 F.Supp. 915 (E.D. N.Y. 1967); Chase Nat. Bank vs. U.S. Trust Co., 236 App. Div. 500, 260 N.Y.S. 40 (1st Dep't 1932).

No party to this litigation disputes that the assets of the Raymond Group had tremendous value in 1973. The Raymond Group had substantial lands in the Wilkes-Barre-Scranton area of Pennsy-

lvania which were rich in anthracite coal reserves. The Raymond Group owned valuable equipment used in the mining and processing of coal as well as valuable culm banks. The Raymond Group's vast lands, culm banks, and coal reserves were, however, highly illiquid assets which could not be sold except over an extended period of time. We are therefore of the opinion that the present fair salable value of the Raymond Group's lands, culm banks, and coal reserves as of November 26, 1973 did not exceed or even approach the Raymond Group's debts and could not produce enough cash to pay the debts of the Raymond Group as they matured.

The fact that the assets were illiquid and could not be sold to produce cash to pay the Raymond Group's debts as they matured is not dispositive of the



issue of solvency. A company with highly illiquid assets would not be insolvent if the operation of its business produced sufficient cash for the payment of its debts as they matured.

The coal production business of the Raymond Group clearly could not produce a sufficient cash flow to pay the company's obligations in a timely manner. The coal business of the Raymond Group had been unprofitable since 1969. There was no reasonable basis for a belief that the coal business would become profitable after November 26, 1973, without a significant rise in coal prices and a substantial capital investment to make the coal operations of the Raymond Group more efficient. While coal prices did rise in 1973 in large measure because of the oil embargo, the increase in prices was not enough to turn around the desperate fi-



nancial condition of the Raymond Group. Furthermore, there was no capital available to the Raymond Group to invest in equipment to make the coal operations more efficient.

The sale of the Raymond Group's surplus lands had provided a fairly substantial cash flow to the Raymond Group prior to November 26, 1973. However, this cash flow was abruptly cut off by the IIT agreement which provided that, for the land sales which occurred in 1974 and 1975, IIT would receive a total of \$1,832,500 out of the first \$2,500,000 of land sale proceeds received by the Raymond Group. The remaining proceeds of \$667,500 would be placed by IIT in a "funded reserve" and would be used to pay the Raymond Group's creditors. However, if the lands were taxed as ordinary income to the Raymond Group, which was

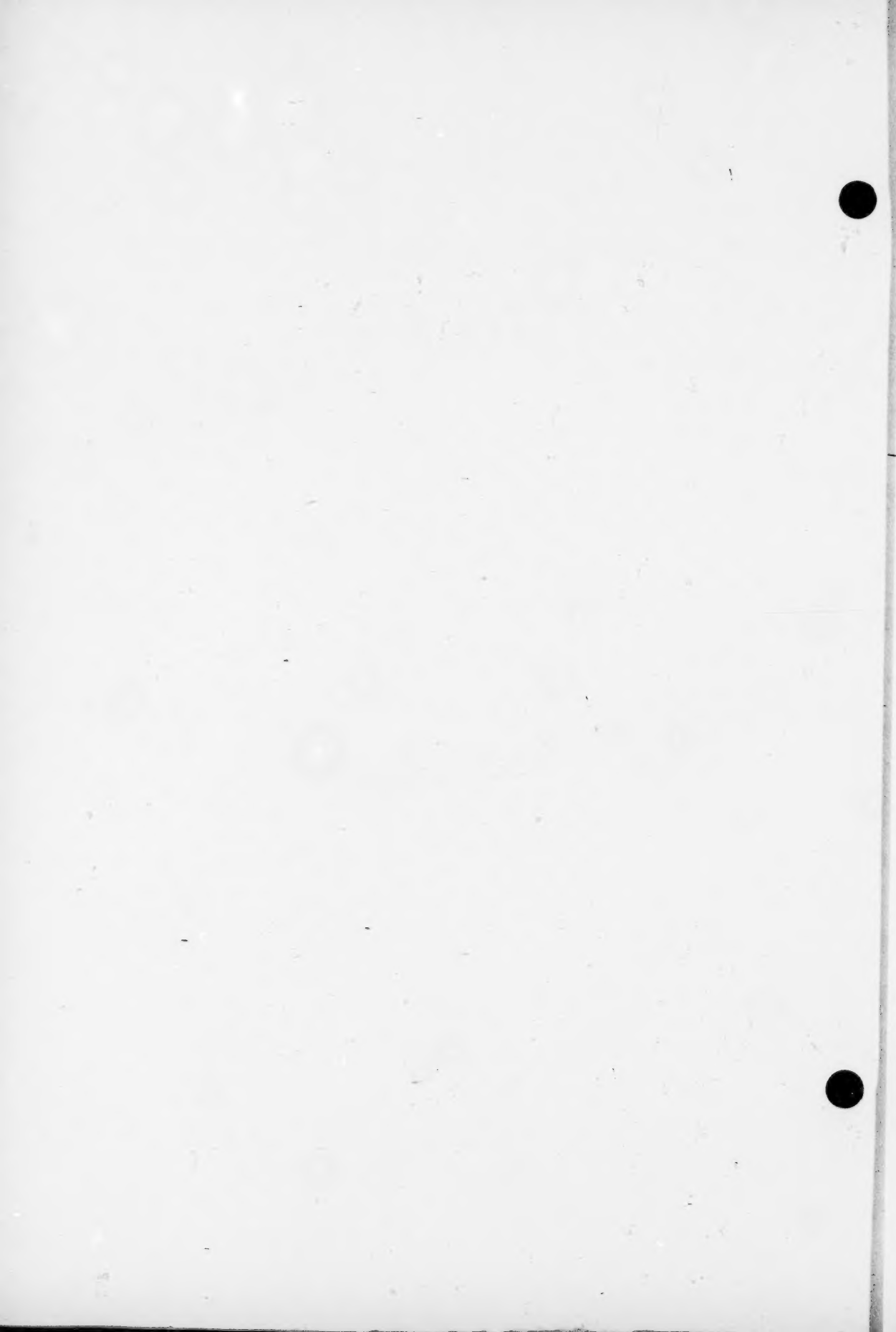
exceedingly likely and in fact came to pass, each land sale would result in a cash loss to the Raymond Group as the amount of federal taxes due would exceed the funds allocated to the "funded reserve" from that sale. Moreover, no cash would be available for creditors other than IIT, the Ford Motor Credit Co. and Thrift Credit from the sale of surplus lands. Thus, the cash that could be generated by the operation of the Raymond Group's business was grossly insufficient to meet its obligations.

One final matter which must be discussed is the possibility of the Raymond Group liquidating its mining equipment to generate the cash needed to pay its debts. A fairly liquid market for used strip mining equipment existed in 1973. Within 7 months of the IIT loan, the Raymond Group sold two pieces of equip-

ment for \$6,000,000. The Defendants produced evidence that all of the equipment of the Raymond Group had a fair market value of between \$6,000,000 and \$22,000,000. However, there was no evidence to indicate how much of this equipment was strip mining equipment having a present fair salable value in 1973. The fact that a fairly liquid market existed for certain types of used coal equipment does not mean that all equipment owned by the Raymond Group was rapidly salable. In addition, much of this equipment was encumbered by purchase money mortgages on which substantial sums were still owed as well as by the IIT security interests. Furthermore, much of this equipment was not surplus in that it was used for then existing coal operations which would cease if the equipment were sold. It is thus evident that the proceeds of the

sales of such equipment would not necessarily be available to the Raymond Group to pay its debts. Indeed, some of the largest and most valuable pieces of equipment owned by the Raymond Group were clearly not salable. One example is the Huber Breaker. Despite the substantial value of the Huber Breaker under proper market conditions, it could not be operated efficiently at 1973 coal prices and, consequently, had a low present, fair, salable value on November 26, 1973. While some of the equipment owned by the Raymond Group could rapidly be liquidated in the used equipment market, there is no evidence that the Raymond Group owned enough of such equipment to permit it to meet its existing debts as they matured.

We are of the opinion that the Raymond Group was insolvent on November 26, 1973 as a result of the IIT transaction



and the instantaneous payment to the selling stockholders of a substantial portion of the IIT loan in exchange for their stock.

We are also of the opinion that the delivery of the mortgages and guarantee mortgages to IIT occurred when the Raymond Group was engaged or about to engage in a "business or transaction for which the property remaining in [its] hands after the conveyance is an unreasonably small capital." 39 Pa.Cons.Stat.Sec. 355. Both before the November 26, 1973 transaction as well as thereafter, the Raymond Group did not have the capital resources it needed to carry on its business. Moreover, Durkin planned to continue selling the surplus lands of the Raymond Group and would therefore incur additional income tax liabilities to the United States. The provisions of the Note Pur-

chase and Loan Agreement were such that relatively little, if any, proceeds of the land sales would be available for general creditors. Durkin also planned to continue the Raymond Group's coal mining operations and would therefore incur additional liabilities to trade creditors, the Anthracite Health and Welfare Fund, and the Commonwealth for backfilling obligations. Moreover, the law under Section 355 of the Act as it has been developed in other jurisdictions is that a finding of insolvency is ipso facto a finding that the debtor was left with unreasonably small capital after the conveyance. *Wydett vs. George*, 336 Mass. 746, 148 N.E. 2d 172 (1958); *Holcomb vs. Nunes*, 132 Cal. App. 2d 776, 780-81, 283 P.2d 301 (1955).

D. Intentional Fraud.

Section 357 of the Pennsylvania Uni-



form Fraudulent Conveyances Act provides:

Every conveyance made and every obligation incurred with actual intent, as distinguished from intent presumed in law, to hinder, delay, or defraud either present or future creditors, is fraudulent as to both present or future creditors.

39 Pa.Cons.Stat. Sec. 357.

The requisite intent under Sec. 357 must be shown by clear and convincing evidence. *Iscovitz vs. Filderman*, 334 Pa. 585, 6 A.2d 270 (1939). Moreover, a conveyance will not be set aside under Sec. 357 if the transferee, in this case IIT, was without knowledge of the fraud and paid a fair consideration for the conveyance. *Godina vs. Oswald*, 206 Pa. Super. 51, 211 A.2d 91 (1965).

Where the transferor and transferee have knowledge of the claims of creditors and know that the creditors cannot be paid and where consideration is lacking for the transfer the Court may infer an

intent to hinder, delay, or defraud creditors. *Godwina v. Oswald*, 206 Pa. Super. 51, 211 A.2d 91 (1965) *Commonwealth Trust Co. of Pittsburgh vs. Reconstruction Finance Corp.*, 120 F.2d 254 (3d Cir. 1941). See also *United States vs. 58th Street Plaza Theatre, Inc.*, 287 F.Supp. 475, 498 (S.D. N.Y. 1968); 4 Collier on Bankruptcy Par.67.37 at 539-43 (14 ed. 1975) (discussing intentional fraud section of the Bankruptcy Act, 11 U.S.C. #107(d)(2)(D) (1970)).

As an initial premise, there can be no doubt that the November 26, 1973 transaction had the effect of hindering and delaying the collection efforts of the Raymond Group's creditors. As a result of the November 26, 1973 transaction, the Raymond Group assumed \$11,922,250 in new debt, most of which was owed to IIT. In exchange therefor \$3,134,654 of ante-



cedent debts of the .Raymond Group were satisfied. The remaining \$8,787,596 was used for purposes which were of no benefit whatsoever to the Raymond Group, such as the purchase of the Raymond Colliery stock from the Gillens and Clevelands.

At the time this massive new debt was assumed by the Raymond Group, it was clearly on the brink of insolvency. The Raymond Group had substantial debts it could not pay and shortly after the closing the Raymond Group was forced to close its mining operations and sell its mining equipment in order to generate the cash needed to pay pressing debts. While the Group had historically met its cash flow needs by the sale of its surplus lands, under the terms of the Note Purchase and Loan Agreement the income flowing from the sale of surplus lands was abruptly curtailed. Because of the financial

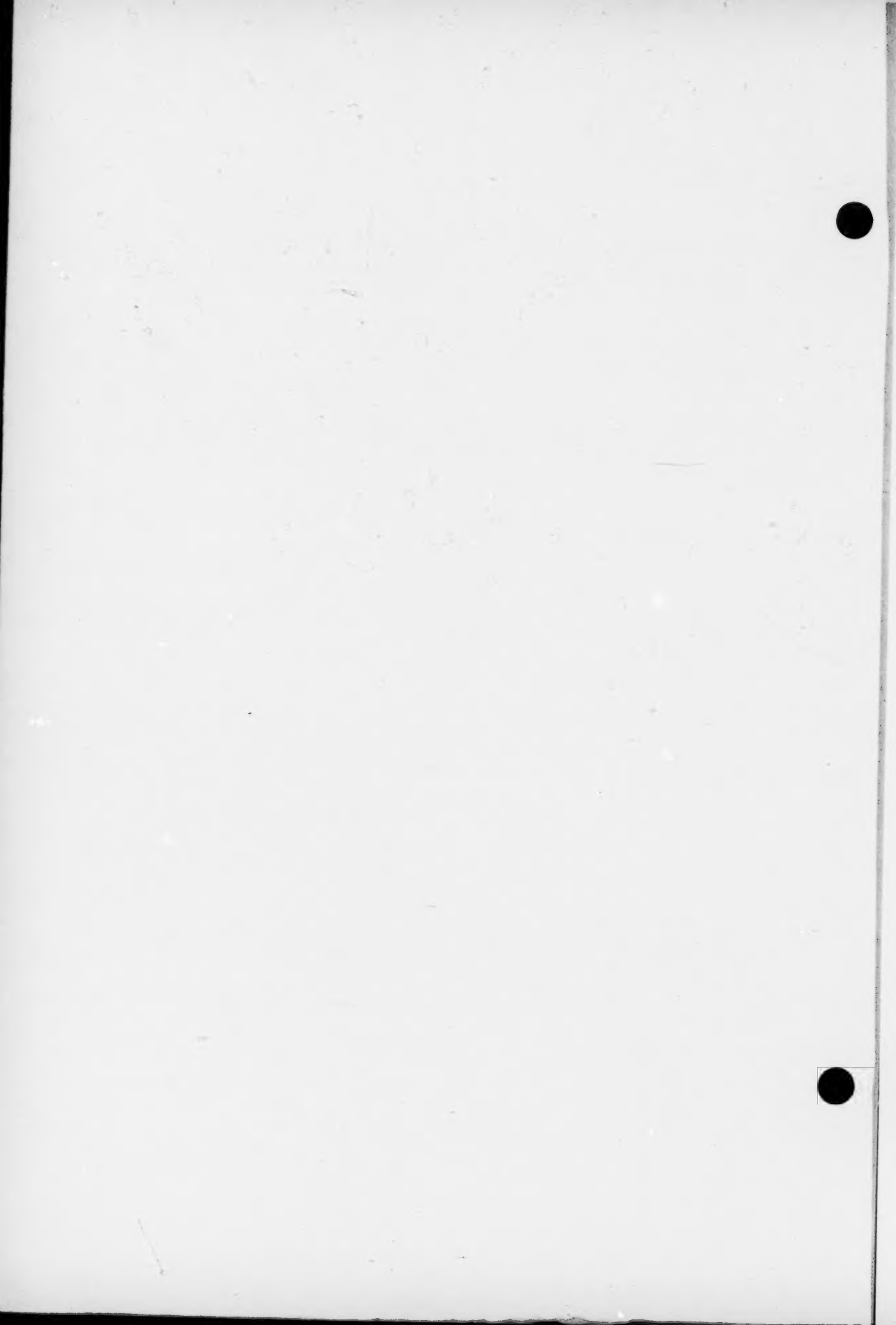


position of the Raymond Group immediately prior to November 26, 1973, the assumption of the IIT obligation secured by mortgages and guarantee mortgages on all of the Raymond Group's assets, and the lack of consideration therefor, we conclude that the IIT obligation had the effect of hindering and delaying other creditors of the Raymond Group.

The question before us at this point is whether this result was intended by the Raymond Group, acting through James Durkin, its president, and by IIT on November 26, 1973. In our view, this question can be answered by examining the knowledge of the parties on November 26, 1973 as to the financial condition of the Raymond Group. If the parties could have foreseen the effect on creditors resulting from the assumption of the IIT obligation by the Raymond Group, a company in

a serious financial condition, the parties must be deemed to have intended the same. Chorost vs. Grand Rapids Factory Show Rooms, Inc., 172 F.2d 327 (3d Cir. 1949); In Re Process-Manz Press, Inc., 236 F.Supp. 333 (N.D. Ill. 1964). This is so despite the fact that neither Durkin nor IIT had the motive to hinder or delay creditors. Indeed, Durkin's motive was to purchase the Raymond Group's stock, and IIT's motive was to engage in a profitable loan transaction.

Neither James J. Durkin Sr. nor IIT had full access to the financial records of the Raymond Group and therefore neither can be charged with knowledge of the minutae relating to the financial condition of the Raymond Group. However, each was aware that the Raymond Group, while rich in assets, had difficulty generating cash. Durkin was informed by his finan-



cial advisor and accountant, Charles Parente, on July 13, 1973, after Parente's review of the Raymond Group's financial records, that the Raymond Group had "not reflected sufficient profits and cash flow to cover debt equivalent to the purchase price of the stock over a reasonable period of time." Plaintiff's Exhibit 883. Durkin also knew that the Raymond Group had substantial liabilities which would have to be met after the loan closing. Indeed, virtually every professional Durkin dealt with in this loan transaction who knew of the Raymond Group's substantial liabilities, including Durkin's counsel, Rosenn, Jenkins, and Greenwald, his financial advisor, Charles Parente, and Hoffa's attorney, Eugene Zafft, warned Durkin that he was taking a very substantial risk in purchasing the Raymond Group through the

proposed method of financing.

IIT must also be charged with knowledge that the Raymond Group had an inadequate supply of cash needed to carry on its business. Almost every witness who was involved with IIT during this period testified that one problem with the loan was that, while it could adequately be secured, no one knew how the company could generate the cash to repay the loan. This knowledge was what led to the creation of the "interest reserve" fund of \$1,530,000. IIT, by creating this fund, intended to relieve the companies from current interest payments on the loan. The loan principal was not amortized and presumably IIT believed that over the next three years the Raymond Group could somehow liquidate enough assets to generate the cash needed to pay off the principal.

We note that John Streiker, the IIT loan administrator, predicted that the Raymond Group would suffer a substantial cash loss after the imposition of the IIT loan obligations. Streiker's predictions were based upon the Raymond Group's June 30, 1972, financial statements and not the Raymond Group's June 30, 1973, statements. Furthermore, the 1973 statements, which were made available to IIT on October 31, 1973, painted a far bleaker picture of the Raymond Group's financial position than did the June 30, 1972 financial statements used by Streiker.

IIT was also aware that the Raymond Group had enormous liabilities to the Commonwealth of Pennsylvania, the IRS, the Anthracite Health and Welfare Fund, and trade creditors, and that the land release provisions in the Note Purchase and Loan Agreement would deprive the

Raymond Group of a major source of cash for general creditors.

Finally, and of great importance, IIT was aware of how its loan proceeds were to be used. Indeed, IIT's own attorneys structured the entire November 26, 1973, transaction. IIT was aware that the bulk of the loan to the borrowing companies would be used to pay the selling shareholders for their stock. IIT was therefore aware that the borrowing companies would receive no fair consideration as compared to the obligations undertaken to IIT. IIT was also clearly aware that the guarantee obligations were not supported by any consideration. We conclude that IIT knew that the Raymond Group would be rendered insolvent by the November 26, 1973, transaction at least in the equitable sense of being unable to pay its debts as they matured.

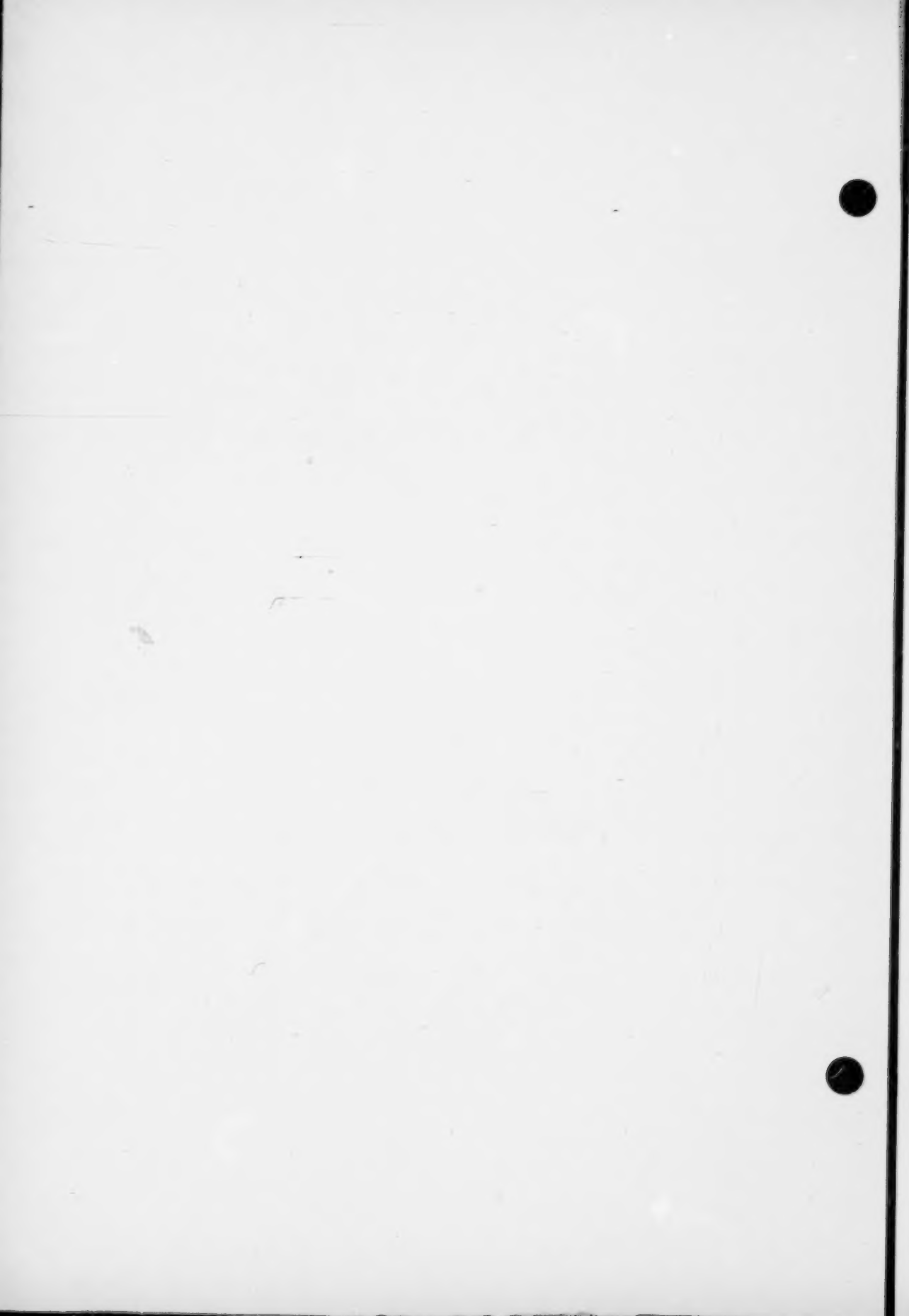
Defendants argue that the large cash advance given the Raymond Group by IIT negates any inference of an intentional fraud. We disagree. Defendants also contend that IIT's actions after November 26, 1973, in administering the loan proved its lack of an intent to defraud creditors. Defendants note that in four sales of the Raymond Group's equipment during the three years after November 26, 1973, IIT released its liens and permitted substantial amounts of the sale proceeds to be used to pay unsecured creditors. Specifically, of the \$8,679,984.00 that Defendants contend was received by the Raymond Group after these sales, \$3,300,919 was used to pay secured creditors senior to IIT, \$3,000,000 was applied to the IIT loan and \$2,379,065 was paid to unsecured creditors. However, the Uniform Fraudulent Conveyances

Act also makes fraudulent an intent to hinder and delay other creditors and IIT's conduct after November 26, 1973 does not rebut the clear inference of such an intent created by the facts in this case

Finally, the Creditors have argued that the concealment by Durkin of James Riddle Hoffa's ownership interest in Great American was somehow indicative of an intent to hinder, delay or defraud Raymond Group creditors. There was not a scintilla of evidence that Hoffa's involvement or the concealment thereof was part of a fraudulent scheme as to creditors.

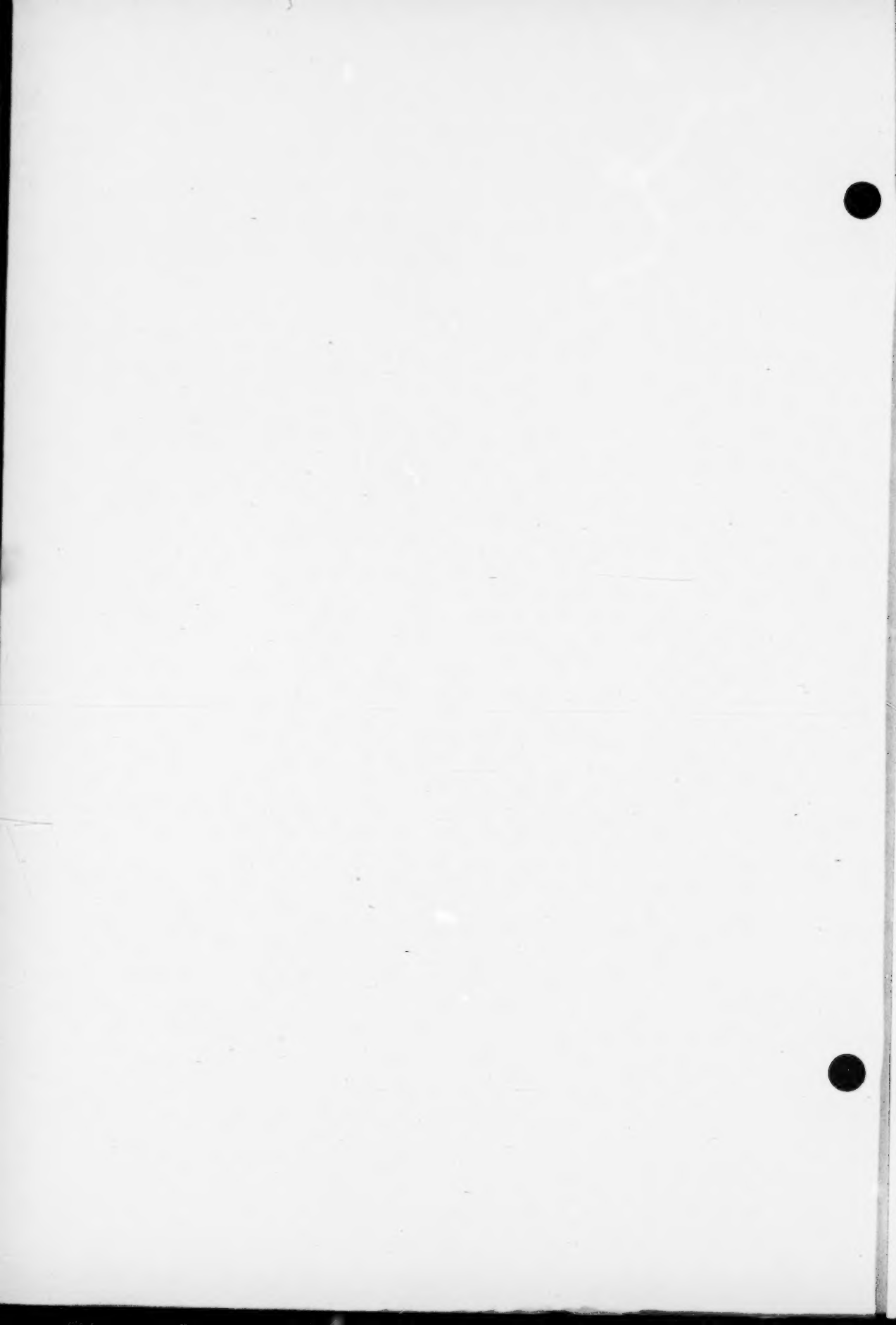
Section 356 of the Act provides:

Every conveyance made and every obligation incurred without fair consideration, when the person making the conveyance or entering into the obligation intends or believes that he will incur debts beyond his ability to pay as they mature, is fraudulent.



lent as to both present and future creditors.

39 Pa.Cons.Stat. Sec. 356. It is clear that Durkin intended or believed that he would incur debts beyond the Raymond Group's ability to pay as they matured. Durkin had every intention of continuing in the land sale business which would result in inadequate funds to pay federal income tax obligations arising from the sale of land because of release provisions in the Note Purchase and Loan Agreement. In addition, Durkin intended to continue mining coal which would result in additional liabilities to trade creditors, the Commonwealth of Pennsylvania, and the Anthracite Health and Welfare Fund. In light of the \$11,000,000 in additional debt Durkin caused the Raymond Group to undertake, it is clear that Durkin knew that he would



be unable to pay the debts which would arise in the course of doing business. This transaction is fraudulent within the meaning of Sec. 356 of the Act.

E. The Liability of the Gillens and Clevelands.

The United States of America and the Trustee in Bankruptcy seek relief against the Gillens and Clevelands, the former shareholders, directors, and officers of the Raymond Group, on the theories that the payment of the stock purchase price was a fraudulent conveyance and that the Gillens and Clevelands breached a duty owed in their capacity as officers, directors, and controlling shareholders to the Raymond Group and its creditors. The Gillens and Clevelands defended against the creditors' claims primarily on the basis that the companies were solvent at the time the stock purchase price was

paid. In addition, the Gillens and Clevelands allege that they had no knowledge of the source of the purchase price for their Raymond Colliery stock nor any reason to believe that the source of that purchase price was assets of the Raymond Group. As such, the Gillens and Clevelands claim they breached no duty owed to either the companies or the companies' creditors.

On April 12, 1983, this Court ordered additional briefing on the question of the liability of the Gillens and Clevelands. The Court also ordered briefing on the defense raised by the Gillens and Clevelands that the statute of limitations had run as to the Creditors' claims.

We are of the opinion that the statute of limitations does not bar this action. While the Pennsylvania statute

of limitations which governs the causes of action alleged by the Creditors against the Gillens and Clevelands has run, 42 Pa.Cons.Stat. Sec. 5527 (6 years), the United States is seeking in this action to enforce rights held in its governmental capacity. Therefore, the state statute of limitations does not apply and the United States can proceed against the Gillens and Clevelands provided it made timely assessments against the taxpayers, 26 U.S.C. Sec. 6501, and timely brought suit to reduce the same to judgment. 26 U.S.C. Sec. 6502. These two requirements have been met and the United States is therefore not barred from seeking relief against the Gillens and Clevelands. See United States vs. Summerlin, 310 U.S. 414, 416 (1940); United States vs. Parker House Sausage Co., 344 F.2d 787 (6th Cir. 1965); United States vs.

Atlantic Richfield Co., 73-1 T.C.
Sec. 9437 (E.D. Pa. 1973).

The Trustee is empowered under the Bankruptcy Act, 11 U.S.C. Sec. 110(c) (1970), to assert the rights of any actual creditor of the bankrupt on the date of bankruptcy. As the United States is a creditor of Blue Coal and Glen Nan and has a cause of action which is not time-barred against the Gillens and Clevelands as former officers, directors, and shareholders of Blue Coal and Glen Nan, the Trustee's claim asserted on behalf of the United States is likewise not barred. *Feldman vs. First National City Bank*, 511 F.2d 460 (2d Cir. 1975); *In Re Dee's, Inc.*, 311 F.2d 619 (3d Cir. 1962). In addition, a second creditor of Blue Coal and Glen Nan, the Commonwealth of Pennsylvania, also has a claim which is not barred by the statute of limitations.

Comm., Dept. of Trans. vs. J.W. Bishop Co., 457 Pa. 58, 439 A.2d 101 (1981) (stating that the doctrine of nullum tempus occurrit regi is applicable where the statute of limitations is asserted as a defense to claims by the state).

Thomas and John Gillen were officers of Raymond Colliery from 1966 until November 26, 1973. Also during that period, members of the Gillen and Cleveland families sat on Raymond Colliery's board of directors. The Gillens and Clevelands were the sole shareholders of Raymond Colliery prior to November 26, 1973.

As officers and directors of Raymond Colliery on November 26, 1973, the Gillens and Clevelands had a duty under Pennsylvania law to hold these positions "in good faith and with that diligence, care and skill which ordinary prudent men would exercise under similar circums-

tances." 15 Pa.Cons.Stat. Sec. 1408. See Rivoli Theatre Co., Inc. vs. Allison, 152 A.2d 449, 396 Pa. 343 (1959); Howell vs. McCloskey, 375 Pa. 100, 99 A.2d 610 (1953); Bailey vs. Jacobs, 325 Pa. 187, 194, 189 A. 320 (1937).

As controlling shareholders of Raymond Colliery, the Gillens and Clevelands were under a duty not to transfer their shares of Raymond Colliery stock "if the circumstances surrounding the proposed transfer are such as to awaken suspicion and put a prudent man on his guard" that the consequences of the transfer would injure the corporation or those interested therein. Insuranshares Corp. vs. Northern Fiscal Corp., 35 F.Supp. 22, 25 (E.D. Pa. 1940). See also Treadway Co., Inc. vs. Care Corp., 638 F.2d 357, 377 n. 38 (2d Cir. 1980); Estate of Hooper vs. Gov't of the Virgin Islands, 427 F.2d 45

(3d Cir. 1970); Vulcanized Rubber & Plastics Co. vs. Scheckter, 400 Pa. 405, 162 A.2d 400 (1960). A breach of a controlling shareholder's duty not to transfer control of a corporation when such a transfer would injure the corporation is most frequently asserted by minority shareholders in a derivative suit but may also be asserted by creditors existing at the time of such a transfer who are injured thereby. Pepper vs. Litton, 308 U.S. 295, 306 (1939); Brown vs. Presbyterian Ministers Fund, 484 F.2d 998, 1005 (3d Cir. 1973); In Re Complete Drywall Contracting Inc., 11 B.R. 697 (E.D. Pa. 1981); Bellis vs. Thal, 373 F.Supp. 120 (E.D. Pa. 1974); Stoneybrook Lumber Co. vs. Blackman, 286 Pa. 305, 133 A. 556 (1926). The United States was clearly a creditor of the Raymond Group on the date the Gillens and Clevelands sold their

7

stock and therefore has standing to complain of their transfer of control. In addition, the Trustee, as representative of the creditors of Blue Coal and Glen Nan on November 26, 1973, has standing to complain of the transfer of control by the Gillens and Clevelands.

It was proven beyond any doubt at trial that the Gillens and Clevelands knew as of November 26, 1973 that the money tendered by Durkin to purchase Raymond Colliery stock was obtained from the IIT loan proceeds given the Raymond Group and secured by the assets of the Raymond Group. The Gillens and Clevelands also knew the IIT loan would be repaid with the Raymond Group's assets. The Gillens and Clevelands were fully aware of how the November 26, 1973, transaction was structured. Additionally, the Gillens and Clevelands as the owners

and operators of the Raymond Group companies were well aware of the Raymond Group's substantial liabilities to various creditors. Indeed, this awareness coupled with the poor earnings of the Group, precipitated the decision of the Gillens and Clevelands to sell their stock.

We are of the view that as controlling shareholders, the Gillens and Clevelands breached their duty to creditors by accepting payment for their stock from the assets of the Raymond Group. These assets consisted of \$4,085,500 in loan proceeds which were funnelled through the Raymond Group to Great American and applied to the purchase price of Raymond Colliery stock. See Stoneybrook Lumber Co. vs. Blackman, 286 Pa. 305 (1926). This transaction, in light of the serious financial condition of the Raymond Group,

clearly harmed not only the corporations but also its existing creditors.

The United States and the Trustee have asserted two additional theories of liability against the Gillens and Clevelands. The first theory is that the payment of the stock purchase price can be likened to an improperly declared dividend or distribution by Raymond Colliery to its shareholders. The second theory is that the transfer of the stock purchase funds was a fraudulent conveyance under the Pennsylvania Fraudulent Conveyances Act.

As to the argument that the payment of the stock purchase price should be likened to an improperly declared dividend or distribution, the directors of the corporation who declared payment of the same can be held liable to creditors of the corporation injured thereby. West

vs. Hotel Pennsylvania, 25 A.2d 593, 595 (Pa.Super. 1942). The director who allegedly declared the improper dividend or distribution was James Durkin, Sr. and he was put in the position to make the distribution by the Gillens and Clevelands as part of the whole transaction. Because the Raymond Group's capital was impaired on November 26, 1973, the declaration of the distribution or dividend was clearly illegal under Pennsylvania law. See Levin vs. Pittsburgh United Corp., 330 Pa. 457, 199 A. 332 (1938). Therefore, the Gillens and Clevelands can be held accountable for the amount of the dividend or distribution.

The fraudulent conveyance theory of liability asserted by the creditors has substantial merit. As developed earlier, a conveyance is fraudulent under Sec. 354 of the Pennsylvania Uniform Fraudulent



Conveyances Act if it is made without fair consideration by one who is or was thereby rendered insolvent. A transfer of funds is clearly a conveyance under the Act. 39 Pa.Cons.Stat. Sec. 351; Toff vs. Vlahakis, 380 Pa. 512 (1955). The Raymond Group was insolvent on November 26, 1973. In addition, no plausible argument has been made or indeed could be made that the Raymond Group received fair consideration for the transfer of its assets to the Gillens and Clevelands. We are of the view that those IIT loan proceeds which were funnelled out of the Raymond Group and applied to the purchase price of Raymond Colliery's stock constituted a fraudulent conveyance under Sec. 354 of the Act.

F. Ultra Vires.

The creditors assert that the various transactions participated in by the Ray-

mond Group companies on November 26, 1973 are invalid because their officers and directors acted beyond the scope of their actual or apparent authority when causing the corporation to participate in the transactions. Even assuming the Board of Directors of the Raymond Group exceeded the corporation's power to mortgage its assets, Section 1303(B) of the Pennsylvania Business Corporate Law provides that "[N]o conveyance or transfer by or to a corporation of property, real or personal, of any kind or description, shall be invalid or fail because...the board of directors or any of the officers of the corporation, acting within the scope of the actual or apparent authority given to them by the Board of Directors, have exceeded any of the corporation's purposes or powers." 15 Pa. Cons.Stat. Sec. 1303(B). We are therefore of the

view that the theory of ultra vires is not available to the Creditors in this action.

IV. Conclusions of Law.

1. This Court has jurisdiction over this action pursuant to 26 U.S.C. Sec. 7402(a) and Sec. 7403 and 28 U.S.C. Sec. 1340 and 1345.

2. The United States is a present creditor of the Raymond Group within the meaning of 39 Pa.Cons.Stat. Sec. 351 et seq. for tax liabilities incurred for fiscal years ended June 30, 1966, June 30, 1967, June 30, 1968, June 30, 1969, June 30, 1972, and June 30, 1973.

3. The United States is a future creditor within the meaning of 39 Pa. Cons. Stat. Sec. 351 et seq. for tax liabilities incurred by the Raymond Group for fiscal year ended June 30, 1975.

4. The Commonwealth of Pennsylvania is a

present creditor of the Raymond Group within the meaning of 39 Pa.Cons.Stat. Sec. 351 et seq. for tax liabilities incurred prior to November 26, 1973 and is a future creditor within the meaning of 39 Pa.Cons.Stat. Sec. 351, et seq. for liabilities incurred after November 26, 1973.

5. On November 26, 1973, the mortgages to IIT given by the Raymond Group were not supported by fair consideration within the meaning of 39 Pa.Cons.Stat. Sec. 353.

6. The Raymond Group was rendered insolvent within the meaning of 39 Pa.Cons.Stat. Sec. 352 by the November 26, 1973, transaction.

7. The conveyances to IIT by the Raymond Group on November 26, 1973 were conveyances by an insolvent within the meaning of 39 Pa.Cons.Stat. Sec. 354.

8. The November 26, 1973 conveyances to IIT were made by a person in business who was engaged in a business or transaction for which the property remaining in his hands was an unreasonably small capital within the meaning of 39 Pa.Cons.Stat. Sec. 355.

9. The November 26, 1973 conveyances to IIT were made by a person who intended or believed he would incur debts beyond his ability to repay as they matured within the meaning of 39 Pa.Cons.Stat. Sec. 356.

10. The November 26, 1973 conveyances to IIT were made with actual intent to hinder and delay present or future creditors of the Raymond Group within the meaning of 39 Pa.Cons.Stat. Sec. 357.

11. The acceptance by the Gillens and Clevelands of funds in payment of the purchase price of Raymond Colliery stock from corporate assets was a breach of

their obligation to the Raymond Group's creditors.

12. The funds conveyed by Raymond Colliery to the Gillens and Clevelands for their stock were made without fair consideration and by an insolvent within the meaning of 39 Pa.Cons.Stat. Sec. 354.

13. The acceptance by the Gillens and Clevelands of funds in payment of the purchase price of Raymond Colliery stock from corporate assets was receipt of an improperly declared distribution.

An appropriate order will be entered in due course at the conclusion of the trial.

/s/

MUIR, U.S. District Judge

DATED: May 20, 1983

UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF PENNSYLVANIA

UNITED STATES OF :
AMERICA, :
- :
Plaintiff : Civil No.80-1424
: :
vs. : Reassigned to
: Judge Muir -
GLENEAGLES INVESTMENT: 3/5/81
CO., INC., et al., :
: :
Defendants :

APPEARANCES:

Beth A. Kaswan
Attorney at Law
Tax Division
U.S. Dept. of Justice
Washington, D.C. 20530
For: Dept. of Justice

Joseph Solfanelli, Esq.
Dolphin, Solfanelli & Butler
Suite 900
Penn Security Bank Bldg.
Scranton, PA 18503
For: Gleneagles Investor

D. Alan Harris, Esq.
Special Deputy Attorney General
300 North State St.
Suite 3607
Chicago, Illinois 60610
For: Commonwealth of Pa.

David Allen Koenigsberg, Esq.

Exhibit "8"

Thomas G. Bailey, Jr., Esq.
Whitman & Ransom
522 Fifth Avenue
New York, New York 10036
For: Pagnotti Enterprises

Robert C. Nowalis, Esq.
Doran & Nowalis
700 Northeastern National Bank Bldg.
69 Public Square
Wilkes-Barre, Pa. 18701
For: Trustee

Sidney Levy, Esq.
Lackawanna County Administration
Building
200 Adams Avenue,
Scranton, Pa.
For: Gillens and Clevelands

Eugene J. Wien, Esq.
Office of District Counsel
Internal Revenue Service
Room 10424
600 Arch Street
Philadelphia, Pa. 19106
For: Internal Revenue Service

UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF PENNSYLVANIA

UNITED STATES OF	:	
AMERICA,	:	
	:	
Plaintiff	:	Civil No. 80-1424
	:	
vs.	:	Reassigned to
	:	Judge Muir
GLENEAGLES INVESTMENT:	:	3/5/81

CO., INC., et al., :
:
Defendants :

OPINION

Muir, District Judge.

I. Introduction.

The first issue of liability in this case was tried beginning November 2, 1982 and ending March 17, 1983. That issue was whether the IIT mortgages given in substantial part to finance the purchase of Raymond Colliery and its affiliates (hereinafter the Raymond Group) were fraudulent conveyances. In an earlier opinion of this Court, *United States of America v. Gleneagles Investment Co., Inc., et al.*, 565 F. Supp. 556 (M.D. Pa. 1983), we concluded that the IIT mortgages were fraudulent.

Trial of the 2nd, 3rd and 4th liability issues started April 18, 1983 and

concluded June 28, 1983. This opinion deals with those issues which were tried in series. The 2nd liability issue was whether the 1976 Lackawanna County tax sale of lands subject to the mortgages was valid. The 3rd liability issue was whether a similar 1980 Lackawanna County tax sale was valid. The 4th liability issue was whether the purchaser of the IIT mortgages was a bona fide purchaser.

On June 15, 1983, during the trial on the 2nd liability issue the parties stipulated that the Lackawanna County Tax Claim Bureau had failed to post tax sale notices on those Raymond Colliery properties which the county had purported to sell at the December 17, 1976 and the December 16, 1980 tax sales, that the tax sales were invalid and that no title passed by the tax sales and resultant tax deeds. Defendant Tabor Court Realty was

the purchaser of Raymond Colliery's lands at the 1976 tax sale. On the date of the 1976 tax sale, Defendant Pagnotti Associates was the equitable owner of the stock of Tabor Court Realty and became the actual owner in January, 1977. At the December 16, 1980 tax sale, Defendant Joseph Solfanelli purchased the properties for \$612,239.56. In January of 1981, Defendant Gleneagles Investment Co., Inc., was incorporated with Joseph Solfanelli as its sole shareholder. Mr. Solfanelli was on December 16, 1980 and is now counsel to the Pagnotti-Tedesco interests. The Lackawanna County Commissioners purported to convey the Raymond Colliery properties to Gleneagles by deed of April 15, 1981. As a result of the June 15, 1983 stipulation, the lands of Raymond Colliery which were ostensibly sold at the tax sales are still owned by

Raymond Colliery and its subsidiaries.

The fraudulent mortgages were assigned by IIT to Defendant McClellan Realty Co. on January 26, 1977. On the same date Defendant Pagnotti Enterprises purchased the stock of McClellan Realty. The United States asserts that the mortgages are void in the hands of McClellan Realty because, inter alia. McClellan Realty knew or had reason to know that the mortgages were fraudulent.

Following are the Court's findings of fact, discussion and conclusions of law with respect to the fourth issue of liability.

11. Findings of Fact.

1. Prior to 1972, James Tedesco had numerous contacts with the Raymond Group and particularly with Raymond Colliery and Blue Coal.

2. In 1965, James Tedesco unsuccessful-

fully attempted to purchase the coal lands of Blue Coal.

3. In 1971, James Tedesco and Louis Pagnotti, II, unsuccessfully attempted to purchase the Loree Colliery culm bank which was owned by the Raymond Group.

4. In 1972, Pagnotti Enterprises and the Raymond Group were the two top producers of anthracite coal in the United States.

5. Pagnotti Enterprises, Inc. is owned 34/60 by the Pagnotti Family, 13/60 by Tedesco Corp. and 13/60 by Henry Venture, Inc.

6. James Tedesco is an experienced coal operator and businessman.

7. James Tedesco has known James Durkin for more than 40 years.

8. In early 1972, James Durkin obtained an option to purchase the stock of Raymond Colliery.

9. Subsequently, James Durkin incorporated Great American Coal Co. and assigned to it his option to purchase the stock of Raymond Colliery.

10. James Durkin financed Great American's purchase of the stock of Raymond Colliery in part through loans obtained from the Old Forge Bank and No. 1 Contracting Co.

11. From 1966 through the present, James Tedesco has been president of Old Forge Bank.

12. James Tedesco and Louis Pagnotti, II are minority shareholders and directors of the Old Forge Bank.

13. No. 1 Contracting Co. is a corporation whose stock is owned by Louis Pagnotti, Inc., Ventre, Inc., and Tedesco Corporation.

14. James Tedesco and Louis Pagnotti, II are shareholders of Tedesco Cor-

poration and Louis Pagnotti, Inc., respectively.

15. At the time James Durkin sought financing from the Old Forge Bank and No. 1 Contracting, he revealed to James Tedesco that he had reached an agreement for the acquisition of Raymond Colliery and its subsidiaries, including Blue Coal.

16. On July 16, 1973, the Old Forge Bank lent James and Anna Jean Durkin \$100,000 towards the purchase of Raymond Colliery's stock without the submission by the Durkins of a loan application or financial statements.

17. On July 16, 1973, No. 1 Contracting Co. entered into a transaction framed as a loan whereby No. 1 Contracting Co. ostensibly lent James and Anna Jean Durkin \$200,000 towards the purchase of Raymond Colliery's stock and accepted

\$300,000 in cash as "collateral".

18. James Riddle Hoffa, Sr. supplied the \$300,000 used as "collateral" for the \$200,000 loan made by No. 1 Contracting Co.

19. James.Riddle Hoffa, Sr. was a silent partner of James Durkin in his negotiations to purchase the stock of Raymond Colliery.

20. The \$300,000 "collateral" was kept in a safe deposit box in the Old Forge Bank used by companies dominated by James Tedesco and drew no interest.

21. James Durkin obtained a written receipt for the cash collateral signed not by the "lender" but by Mr. Sebastianelli, an officer of the Old Forge Bank.

22. James Tedesco, was president of both Old Forge Bank and No. 1 Contracting Co. James Tedesco as president of the

bank did not request loan applications from the Durkins because of his belief that Anna Jean Durkin was wealthy.

23. On August 13, 1973, Old Forge Bank lent Great American \$105,000 without submission by Great American of a loan application or financial statements.

24. Because James Tedesco looked to James and Anna Jean Durkin for repayment of the Old Forge Bank loan to Great American, he did not request financial statements for Great American or for the Raymond Group.

25. James Tedesco was not shown any financial statements of the Raymond Group on July 16, 1973 or on August 13, 1973.

26. In the summer of 1973, Hyman Green became a joint venturer with James Durkin and James Riddle Hoffa in the negotiations to purchase Raymond Colliery.

27. Prior to 1973, representatives of several anthracite coal companies, including Joseph Frank a direct assistant of Mr. Tedesco on behalf of Pagnotti Enterprises and Carl Tomaine on behalf of the Raymond Group, entered into agreements to fix prices and control production of anthracite coal.

28. On October 11, 1973, Henry Greenwald, counsel for James Durkin, sought from James Tedesco information regarding the amount of counsel fees and expenses paid by Blue Coal or for which it had become obligated with respect to the antitrust litigation which arose out of the price fixing and production control activities set forth in the last preceding finding of fact. Henry Greenwald explained that this information was needed to resolve a dispute which had arisen in the course of James Durkin's

negotiations to purchase Raymond Colliery.

29. On or about October 31, 1973, James Tedesco provided Henry Greenwald with an appraisal of a Bucyrus-Erie Electric Walking Dragline owned by a member of the Raymond Group valuing the dragline at \$2,500,000.

30. This appraisal was used by James Durkin to support his efforts to obtain financing from Institutional Investors Trust (IIT) for the purchase of the stock of Raymond Colliery.

31. In early 1974 James Tedesco knew about James Durkin's efforts, after Great American's purchase of Raymond Colliery, to liquidate the Raymond Group. Specifically, James Tedesco was aware that James Durkin had sold or was attempting to sell equipment, culm banks and draglines owned by the Raymond Group.

32. In January of 1974, James Tedesco had discussions with James Durkin and Hyman Green regarding the possibility that Pagnotti Enterprises might acquire a "lease to exhaustion" of all coal lands of the Raymond Group.

33. The proposal discussed among James Tedesco, Hyman Green, and James Durkin contemplated that Pagnotti Enterprises would have the use of the mining equipment owned by the Raymond Group.

34. James Tedesco did not see any financial statements or data on the financial condition of the Raymond Group at this time.

35. During the January, 1974 negotiations, James Durkin advised James Tedesco that the Raymond Group was losing money on its coal production business and intended to cease operation of the same.

36. No agreement on the lease to

exhaustion proposal was reached between James Tedesco, James Durkin, and Hyman Green.

37. Later in 1974, James Durkin and Hyman Green entered into a lease to exhaustion with Lucky Strike Coal Corp. of certain Raymond Group coal lands.

38. Lucky Strike Coal was operated by Louis Beltrami.

39. Prior to April 1974, James Tedesco offered James Durkin \$2,500,000 for the Bucyrus-Erie Electric Walking Dragline which was the subject of the appraisal provided by James Tedesco to Henry Greenwald in October of 1973.

40. This offer was not accepted by James Durkin and subsequently the dragline was sold for \$3,000,000 to W. R. Grace & Co.

41. On July 18, 1974, James Durkin, Anna Jean Durkin and Hyman Green pledged

their Raymond Colliery and Great American stock to IIT as additional collateral for the 1973 loans.

42. In accordance with the pledge agreement, in the event of default IIT had the right to vote the pledged stock and to exercise all powers of an owner with respect to the pledged stock.

43. The Durkins became seriously delinquent in the payment of interest on the Old Forge Bank loan and on the "loan" from No. 1 Contracting Co. obtained by the Durkins on July 16, 1973 in connection with the purchase of Raymond Colliery stock.

44. On May 6, 1975 the interest payable on the \$200,000 "loan" from No. 1 Contracting Company to James and Anna Jean Durkin was paid by Blue Coal for the period July 1, 1973 through December 31, 1973.

45. On June 26, 1975, James and Anna Jean Durkin sold their stock in Great American to Hyman Green.

46. After the Durkins sold their stock, James Millard became president of both Raymond Colliery and Blue Coal.

47. James Millard was counsel to Hyman Green at least between 1973 and 1976.

48. In September 1975, James Tedesco negotiated on behalf of Loree Associates to lease a coal breaker to the Durkins for the processing of certain culm banks.

49. In 1975, Raymond Colliery negotiated an agreement with the Lackawanna Tax Claim Bureau to pay its delinquent real estate taxes.

50. Upon signing this agreement, Raymond Colliery paid \$95,000 towards its taxes and agreed to pay the balance of \$885,000 in installments during 1976.

51. By early 1976, Raymond Colliery was in default under this agreement.

52. In January, 1976, James Durkin accompanied by Eugene Zafft met with James Tedesco and repaid the \$200,000 No. 1 Contracting Co. and James Tedesco delivered to them the \$300,000 "cash collateral." At this time, James Durkin stated he had assigned his interest in the "cash collateral" to Eugene Zafft.

53. Eugene Zafft was counsel to James Riddle Hoffa at least from 1972 until Hoffa's disappearance in 1975 and in January of 1976 was acting on behalf of Hoffa's estate.

54. At the time the "cash collateral" was returned, James Durkin and James Tedesco exchanged receipts.

55. In February, 1976 Blue Coal negotiated an agreement with the Luzerne County Commissioners to pay its delin-

quent real estate taxes.

56. Under the agreement, Blue Coal paid \$50,000 towards its taxes with further payments to be made from the proceeds of its real estate sales.

57. The \$50,000 so paid by Blue Coal was advanced to Blue Coal by IIT and was added to the principal amount of the IIT mortgages. The advance was secured by a promissory note executed by Blue Coal and guaranteed by James Millard.

58. In early 1976, L. Robert Lieb was retained by IIT as special counsel to advise IIT with respect to the Raymond Group loans.

59. L. Robert Lieb was not told about the background or origin of the IIT loans.

60. By mid-1976, Blue Coal was in default under its agreement with the Luzerne County Commissioners.

61. On September 15, 1976, IIT sent notices to Raymond Colliery, Olyphant Associates, Blue Coal and Glen Nan (the borrowing companies) declaring that the mortgage notes under the Note Purchase and Loan Agreement of November 26, 1973 were in default. IIT further advised the borrowing companies that it was accelerating the balances due under the Note Purchase and Loan Agreement and demanded payment of the loan balances. Similar notices of default were sent to the corporate guarantors.

62. On September 15, 1976, IIT made demands upon Lucky Strike to pay to IIT all rents payable by Lucky Strike to the Raymond Group under the lease to exhaustion held by Lucky Strike.

63. On September 29, 1976, IIT confessed judgments against Blue Coal, Raymond Colliery, Olyphant Associates and

Glen Nan in the amounts of \$3,075,438, \$1,865,430, \$50,417 and \$50,417 respectively.

64. In the fall of 1976 Lawrence Sullivan of IIT approached James Tedesco to discuss the sale of IIT's mortgages to Pagnotti Enterprises.

65. At the meeting with Lawrence Sullivan, James Tedesco indicated a willingness to consider purchasing IIT's mortgages and requested that copies of the mortgages and other data be provided to Pagnotti Enterprises.

66. Pursuant to this request, Lawrence Sullivan sent James Tedesco copies of the four mortgages, one relating to each borrowing company, and an index of the items in the twelve closing binders created by IIT's counsel, Morgan, Lewis and Bockius, after the November 26, 1973 closing of the IIT loans.

67. By October 20, 1976, James Tedesco and his counsel, Morris Gelb of the Scranton law firm of Gelb & Myers, had received the above documents from Lawrence Sullivan.

68. Also during October 1976, James Tedesco was approached by Hyman Green, owner of record of the stock of Raymond Colliery, who represented to James Tedesco that the IIT mortgages could be purchased at a substantial discount.

69. Hyman Green and James Millard used the threat of bankruptcy and the possible county tax sales in an attempt to get IIT to modify or extend the maturity date of the loans.

70. IIT advised Mr. Green that it would not modify the terms or extend the maturity date of the loans.

71. Hyman Green was attempting to find a buyer of IIT's loans and security

because he wanted the mortgages to be held by someone who would be more cooperative with the Raymond Group than IIT had been and because IIT had indicated that it would not extend the December 31, 1976 maturity date of the loans or refinance the loans past that date.

72. James Tedesco had a meeting with Hyman Green in late October, 1976 in Hyman Green's offices in New York.

73. Attorney Morris Gelb and his associate, Richard Bishop, as counsel to Pagnotti Enterprises, and James Millard, president of Blue Coal and Raymond Colliery, were also present at the above meeting.

74. James Tedesco and Hyman Green discussed the possible sale of the Raymond Group to Pagnotti Enterprises but James Tedesco lost interest in the possibility of a stock purchase after he and

his counsel reviewed the financial information concerning the Raymond Group.

75. The Raymond Group was unable to pay its delinquent and current real estate taxes through December 1976 which aggregated approximately \$980,000 for Lackawanna County alone.

76. In the fall of 1976, Luzerne and Lackawanna Counties scheduled real estate tax sales of the bulk of the lands of Raymond Colliery and Blue Coal.

77. On or after October 5, 1976, IIT made efforts to pay Raymond Colliery's and Blue Coal's delinquent real estate taxes. IIT unsuccessfully attempted to negotiate an agreement with the taxing authorities to pay the taxes on an installment basis.

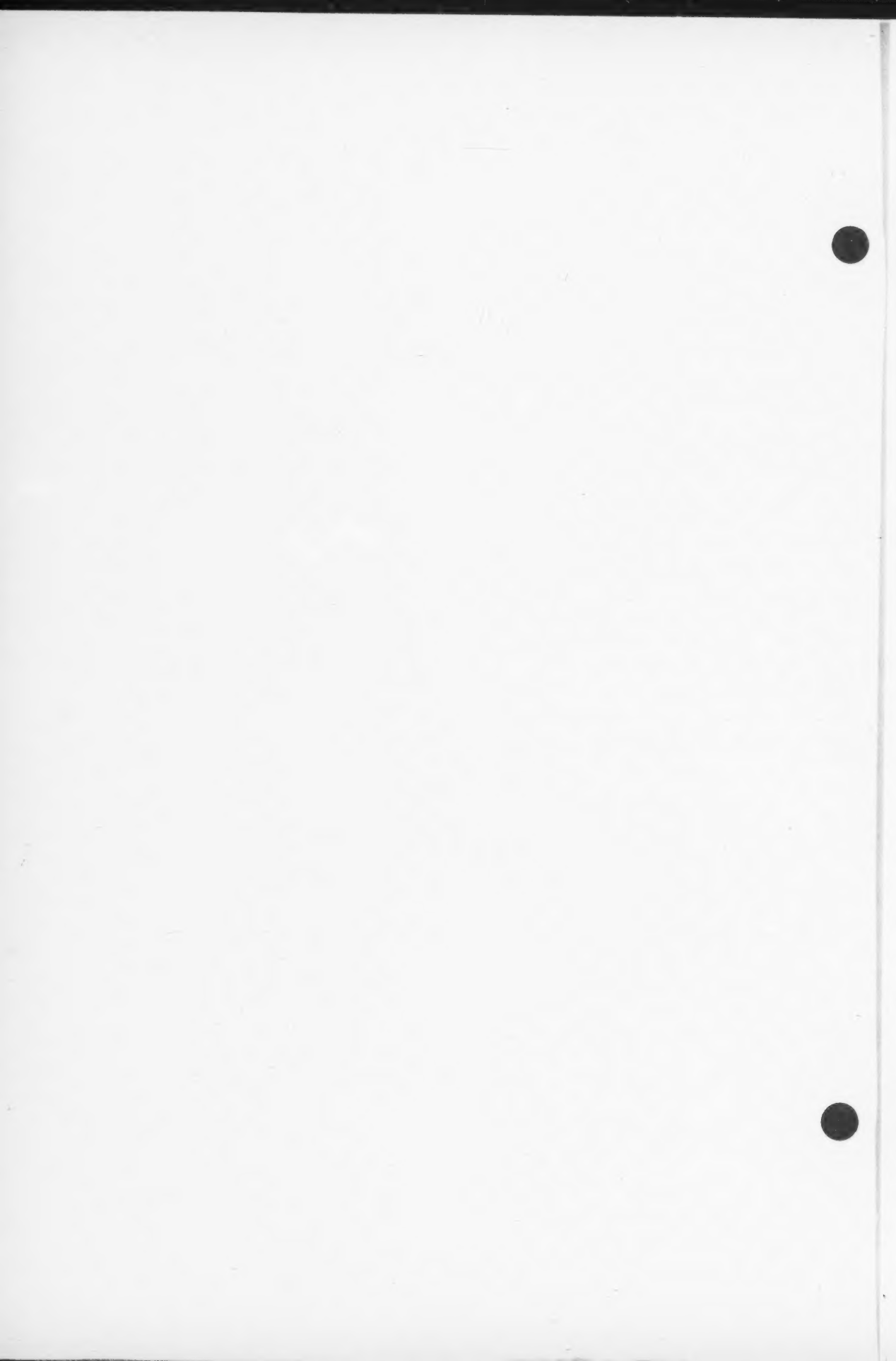
78. Between November 9, 1976 and November 12, 1976, L. Robert Lieb and Allen Katz, counsel for IIT, met with and



retained Norman Harris and Merton Jones of Nogi, O'Malley and Harris, a Scranton area law firm, as local counsel to IIT and discussed with them and various county personnel the alternatives available to IIT to protect its mortgages in light of the scheduled county tax sales and the fact that the mortgages were in default.

79. In November, 1976, IIT's counsel visited the Luzerne and Lackawanna County Tax Claim Bureaus.

80. L. Robert Lieb learned during his visit to the County Tax Claim Bureaus that certain real estate taxes owed by Blue Coal and Raymond Colliery pre-dated the November 26, 1973 mortgages. L. Robert Lieb was surprised that real estate taxes which pre-dated the mortgages had not been paid prior to the November 26, 1973 closing, but understood that non-payment of real estate taxes was a



method of "borrowing" at an interest rate substantially lower than the prime rate.

81. Because some of the delinquent real estate taxes owed by Raymond Colliery and Blue Coal predated the IIT mortgages, IIT was aware that under Pennsylvania law tax sales based upon such pre-1974 taxes would discharge IIT's mortgages.

82. As a result of IIT's awareness that the tax sales involving taxes pre-dating the mortgages would discharge its mortgages, IIT considered what steps would be necessary to protect its mortgages.

83. Representatives of IIT unsuccessfully attempted to persuade the owners of Blue Coal and Raymond Colliery to pay the delinquent real estate taxes.

84. IIT's counsel learned that the Lackawanna County tax records and files

were confused, the Lackawanna County officials were political appointees and the Lackawanna County officials appeared to be assisting a potential purchaser in his effort to obtain Raymond Colliery's lands at a bargain price.

85. James Tedesco's name as a potential purchaser at a bargain price was not mentioned by the Lackawanna County employees.

86. IIT employed a team of accountants to examine Lackawanna County's tax records and employed a consultant to advise IIT as to the advisability of paying taxes on specific parcels of property, purchasing specific parcels of property at the tax sales, purchasing all of the tracts at the tax sales, or a combination of these methods.

87. IIT's accountants were unable to determine the amounts owed on the taxes

owed to Lackawanna County.

88. IIT's real estate consultant, Kenneth P. O'Brien, was unable to determine the identity and whereabouts of scores of Raymond Colliery's properties proposed to be offered for tax sale by Lackawanna County and, as a result, was unable to advise IIT on whether it should pay taxes or bid upon particular parcels of Raymond Colliery property.

89. On November 15, 1976, a meeting between IIT personnel and their counsel, L. Robert Lieb, Allen Katz, Norman Harris, and Merton Jones was held in the New York offices of IIT to develop a strategy to protect the mortgages at the scheduled county tax sales and to consider whether IIT should take possession of the lands in order to be clothed with the benefits accorded a mortgagee in possession.

90. IIT rejected mortgagee in pos-



session status because it believed such a course of action might give rise to potential liabilities to the Raymond Group's creditors.

91. IIT also considered exercising its rights under the stock pledge agreement, voting in a new board of directors for Raymond Colliery, filing on behalf of Raymond Colliery a voluntary bankruptcy petition and attempting to stay the Lackawanna County tax sale.

92. IIT also considered foreclosing on its mortgages but recognized the likelihood that once a foreclosure was commenced, an involuntary bankruptcy proceeding of some sort would probably follow.

93. IIT determined that a bankruptcy should be avoided as it would delay for several years IIT's efforts to collect the amounts due under the mortgages at a

time when IIT was experiencing great cash flow problems.

94. In December 1976, Norman Harris, IIT's local counsel, requested Bankruptcy Judge Gibbons in Wilkes-Barre to inform IIT immediately should a bankruptcy petition be filed against Blue Coal or Raymond Colliery.

95. In late November or early December, 1976, IIT's counsel drafted affidavits and pleadings to seek a federal court injunction of the Lackawanna County tax sale of Raymond Colliery's properties on the basis of IIT's contention that the sale would violate due process of law notice requirements.

96. Before IIT had selected a final strategy to be used at the county tax sales, IIT and James Tedesco on behalf of Pagnotti Enterprises resumed negotiations for the purchase of IIT's mortgages by



Pagnotti Enterprises.

97. Prior to these negotiations, Pagnotti Enterprises secured an agreement from Hyman Green whereby Hyman Green promised to execute "declarations of no set-off" confirming the balances owed on the IIT loans.

98. Pagnotti Enterprises secured from Hyman Green on December 10, 1976, "declarations of no-set off" confirming the balances of the IIT loans owed by the four borrowing companies and warranting that the mortgagors had no knowledge of any claims or defenses to the mortgages.

99. On December 13, 1976, a meeting of IIT, their counsel, and Robert Casper, a real estate appraiser retained by IIT, was held at IIT's offices in New York in order to select a final strategy to be utilized with respect to the county tax sales.



100. Because the December 10, 1976 "declarations of no set-off" were not properly executed, Hyman Green was requested to re-execute "declarations of no-set off" and to have them properly acknowledged.

101. On December 14, 1976, James Tedesco accompanied by Morris Gelb and Richard Bishop, counsel for Pagnotti Enterprises, met with IIT personnel and counsel in New York to negotiate the purchase of IIT's mortgages by Pagnotti Enterprises.

102. Further negotiations were held on December 15, 1976 in the law offices of Gelb & Myers in Scranton, Pennsylvania.

103. The December 15, 1976 meeting was attended by Morris Gelb, L. Robert Lieb, Allen Katz, and Norman Harris and was convened for the purpose of drafting

an agreement of sale of the IIT mortgages to Pagnotti Enterprises or its nominee.

104. At the meeting held on December 15, 1976, there were discussions regarding the effect of an intervening bankruptcy on the IIT mortgages and on the duties of the parties to go forward with the sale of the mortgages in the event of bankruptcy.

105. At the December 14 and 15, 1976 meetings, L. Robert Lieb warned James Tedesco of Hyman Green's bankruptcy threats and specifically negotiated a contract clause providing that a bankruptcy of any of the debtors would have no effect upon the obligation of Pagnotti Enterprises under the mortgage sale contract.

106. Prior to the tax sales, the question of whether other liens on the properties would be divested by a county



tax sale was discussed and was a subject of much concern.

107. Morris Gelb was of the view that it was difficult to determine whether or not a tax sale would divest other liens on the properties sold at such a sale.

108. Local counsel for IIT told L. Robert Lieb that a quiet title action would probably be necessary effectively to divest all liens on properties sold at a county tax sale.

109. At the December 14 and 15, 1976 meetings between Pagnotti Enterprises and IIT, counsel for IIT emphasized that the mortgage debts were being sold "as is" and with absolutely no representations or warranties.

110. James Tedesco had previously insisted upon an escape clause for the proposed purchase of the IIT mortgages in the event that there was some invalidity

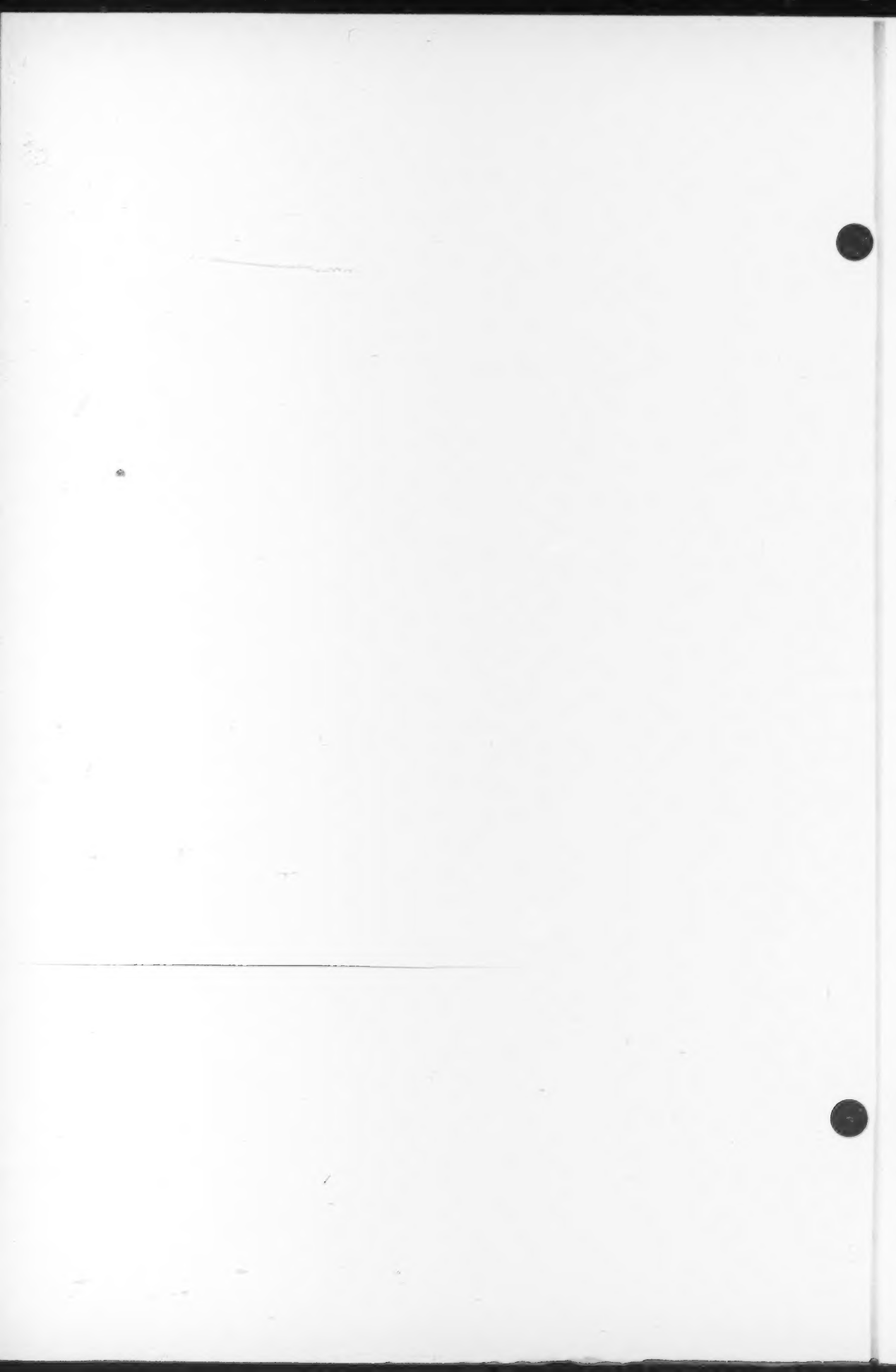
to the mortgages. However, James Tedesco agreed to an unconditional purchase of the mortgages in exchange for a reduction of the purchase price.

111. When negotiating to purchase the IIT mortgages, James Tedesco knew, in addition to the items of his knowledge found above, that the debtors were in default, that the loan balances had been accelerated and that judgments on the unpaid balances had been confessed.

112. There was no discussion between representatives of Pagnotti Enterprises and IIT about the possibility of mortgages being held invalid as fraudulent conveyances.

113. In 1976, L. Robert Lieb had no knowledge or indication of any challenge to the validity of the IIT loans.

114. During the negotiations to purchase the IIT mortgages, James Tedesco

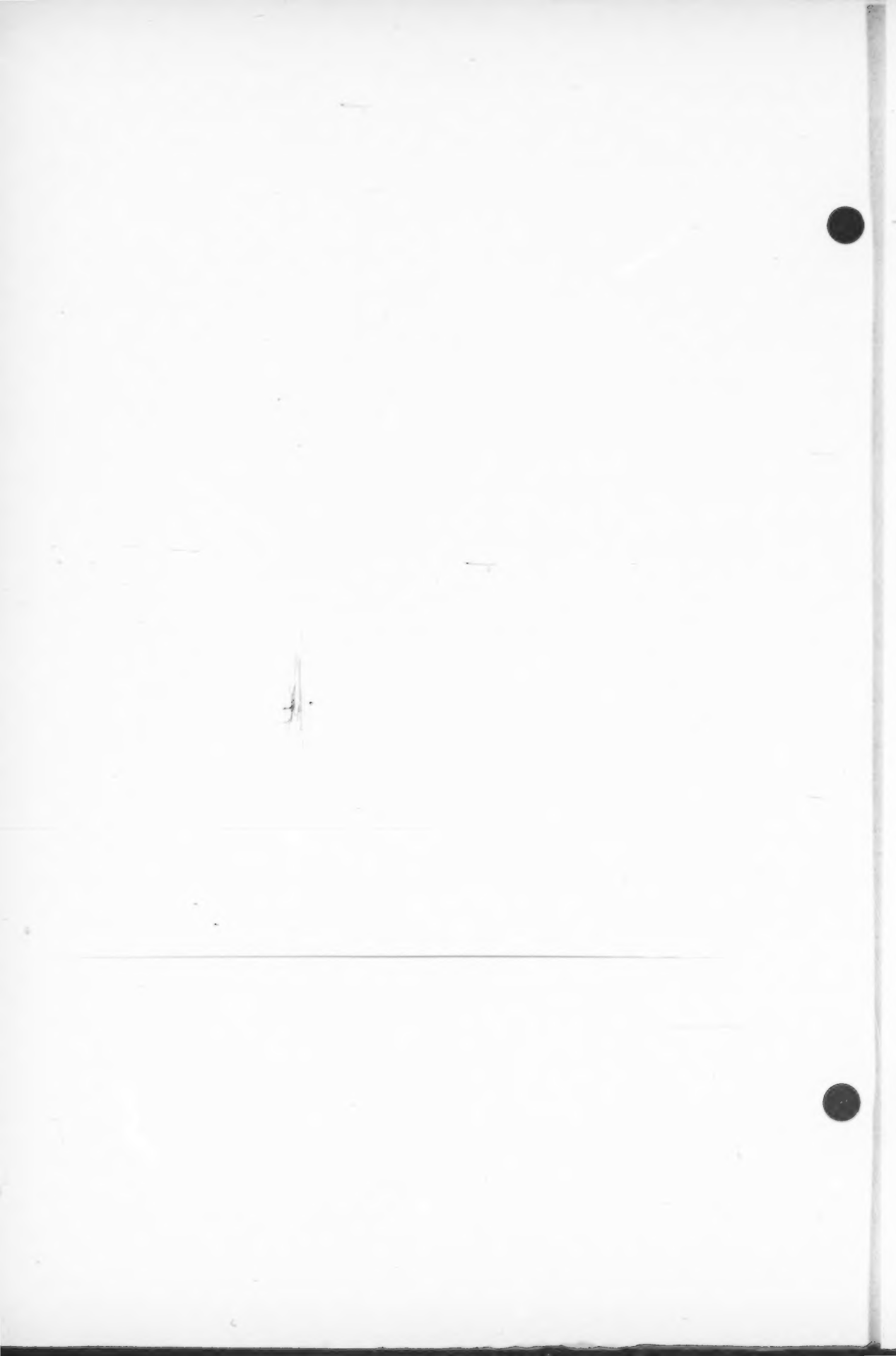


and his counsel were given the opportunity to review all the November 26, 1973 loan closing documents.

115. These documents were contained in 12 closing binders prepared by Morgan, Lewis and Bockius after the November 26, 1973 closing of the IIT loans, the index to the binders having been received by James Tedesco and Morris Gelb by October 20, 1976.

116. Copies of most, if not all, of the twelve binders were in the possession of Nogi, O'Malley and Harris, IIT's local counsel in Scranton, Pennsylvania, and were available for review by Pagnotti Enterprises' officers and counsel.

117. All other correspondence and other paperwork relating to the Raymond Group mortgages were kept in three 4-drawer filing cabinets at IIT's New York offices.



118. During the negotiations to purchase the IIT mortgages, James Tedesco knew, or had in his possession the index to the closing document which index showed on its face that the proceeds of the IIT loan had financed at least in part the 1973 purchase by Great American of Raymond Colliery's stock.

119. The 1973 IIT loan closing binders clearly reflect that the IIT loans were made in connection with a transfer of control of the stock of Raymond Colliery and were made in large part to finance the purchase of the stock of the Raymond Group.

120. During the negotiations to purchase the IIT mortgages, James Tedesco did not have actual knowledge of the precise amount of the IIT loan proceeds which were paid to the prior owners of Raymond Colliery.



121. The index to the closing binders reflects that the binders included the June 30, 1973 financial statements of the Raymond Group.

122. Documents in the 1973 IIT loan closing binders clearly reflect that when the IIT loans were made the Raymond Group was having serious financial difficulties.

123. L. Robert Lieb had no knowledge that the Raymond Group was experiencing financial difficulties in November, 1973 or whether the Raymond Group was solvent in 1973.

124. The Raymond Group's difficulties with creditors during 1973 through 1976, including disputes with the Anthracite Health and Welfare Fund, injunction actions brought by creditors, and county tax sale notices of the Raymond Group's lands, were well publicized in the

Wilkes-Barre and Scranton areas.

125. In December of 1976, Richard Bishop, counsel for Pagnotti Enterprises, reviewed the closing index from the 1973 transaction, the Note Purchase and Loan Agreement and at least some of the IIT mortgages on record in Lackawanna and Luzerne Counties.

126. The documents from the 1973 loan were complex and Richard Bishop expended much effort in attempting to understand the November 26, 1973 transaction.

127. The IIT mortgage documents were so complex that IIT loan administrators might not have been able to understand them.

128. James Tedesco relied upon the Chicago Title insurance policy issued in connection with the November 26, 1973 transaction at least in part in negotiating the purchase of the IIT mortgages.

7.

129. The Chicago Title insurance policy on its face insured the IIT direct mortgages except against usury and claims under consumer credit laws.

130. The Chicago Title insurance policy made no reference to the enforceability of the guarantee mortgages.

131. L. Robert Lieb was not surprised that the guarantee mortgages were not covered by the title policy because title insurance companies do not ordinarily issue insurance for guarantee mortgages.

132. Morris Gelb concluded that a mortgage closed by Morgan, Lewis and Bockius, with a title insurance policy issued by Chicago Title Insurance Company and an opinion letter issued by Rosenn, Jenkins and Greenwald, would have little or no chance of being invalid.

133. Pagnotti Enterprises was primarily concerned with whether the IIT mort-

gages were first liens on the Raymond Group's assets and with the value of these assets.

134. James Tedesco determined that there was enough value in the Raymond Group assets to which the mortgages attached to pay both the principal and the interest on the IIT loans.

135. On December 15, 1976, IIT and James Tedesco on behalf of Pagnotti Enterprises signed a contract for the sale of the IIT loans and security interests to Pagnotti Enterprises or its nominee (hereinafter "the mortgage sale contract").

136. In 1976, James Tedesco had no independent knowledge of the current earnings of the Raymond Group.

137. Pagnotti Enterprises was not in the business of buying mortgages.

13B. Pagnotti Enterprises entered

into the mortgage sale contract with an intent to foreclose on the mortgages if third parties acquired the properties at the tax sale but with the intent not to foreclose if a nominee of Pagnotti Enterprises were the successful bidder at the tax sale.

139. James Tedesco hesitated in executing the IIT mortgage sale contract when he realized that he could not obtain "tax title" free and clear of liens to all of Blue Coal's coal lands because Lucky Strike Coal Company had paid the Luzerne County real estate taxes on the coal lands which it had under lease and, therefore, these lands were no longer scheduled to be sold at the tax sale.

140. The sale by IIT of its Raymond Group loans and security to Pagnotti Enterprises was understood by IIT and James Tedesco to be the vehicle for ef-

Raymond Group.

141. Pursuant to the mortgage sale contract, L. Robert Lieb was authorized by Pagnotti Enterprises and IIT to act as agent for both parties.

142. Upon executing the mortgage sale contract, James Tedesco, for Pagnotti Enterprises or its nominee, delivered to L. Robert Lieb as escrowee a \$600,000 deposit.

143. Upon executing the mortgage sale contract, IIT delivered to L. Robert Lieb as escrowee a \$600,000 deposit.

144. The escrowed funds were to be applied for the payment of delinquent real estate taxes on properties covered by the IIT mortgages, for the bidding in or on the properties covered by the mortgages, or for some combination thereof to be determined by Pagnotti Enterprises.

145. One objective of bidding at the

tax sale was to put IIT and Pagnotti Enterprises in a more secure position vis-a-vis other creditors.

146. Once the IIT mortgage sale contract was executed, James Tedesco became the decisionmaker for purposes of determining what joint action would be taken by IIT and Pagnotti Enterprises at the county tax sales.

147. Pagnotti Enterprises and IIT inserted a provision in the mortgage sale contract of December 15, 1976 that the \$600,000 deposit made by Pagnotti Enterprises would be forfeited should Pagnotti Enterprises refuse to complete the terms of the mortgage sale contract.

148. Pursuant to the terms of the mortgage sale contract, IIT represented to Pagnotti Enterprises that it had no knowledge of defenses to the IIT mortgage notes to be assigned to Pagnotti Enter-



prises or its nominee.

149. Pursuant to the terms of the mortgage sale contract, Pagnotti Enterprises agreed to pay all expenses incident to the county tax sales, including recording costs and preparation of tax deeds.

150. Pursuant to the terms of the mortgage sale contract, Pagnotti Enterprises agreed to reimburse IIT for all monies advanced by IIT and used either to pay delinquent real estate taxes or to bid in or on the properties at the tax sales.

151. Pursuant to the terms of the mortgage sale contract, IIT and Pagnotti Enterprises agreed that no commissions or brokerage fees for the sale of the mortgages would be payable by either party.

152. Pursuant to the terms of the mortgage sale contract, IIT and Pagnotti

Enterprises agreed to undertake their best efforts to delay both of the tax sales scheduled for December 17, 1976, primarily to permit a thorough search of the tax records so as to determine on which lands to bid and the amounts of taxes actually owed on each parcel.

153. IIT abandoned its efforts to enjoin the county tax sales as a result of its execution of the contract to sell its mortgage debts to Pagnotti Enterprises.

154. Pagnotti Enterprises and IIT agreed that all bidding at the tax sale would be done in the name of a nominee corporation, the stock of which would be delivered to Pagnotti Enterprises or its nominee at the closing of the sale to Pagnotti Enterprises of the IIT loans and securities.

155. IIT and Pagnotti Enterprises

agreed that the bidding would be done in the name of a nominee corporation in order to avoid the merger of the IIT mortgages and the tax sale titles.

156. On December 15, 1976, L. Robert Lieb formed two New Jersey corporations, Tabor Court Realty, Inc. and McClellan Realty Corporation.

157. Tabor Court Realty was formed to bid on Raymond Colliery's properties at the Lackawanna County tax sale and to take title to the same.

158. McClellan Realty was formed to bid on Blue Coal's properties at the Luzerne County tax sale and to take title to the same.

159. Pagnotti Enterprises developed a list of properties which it did not choose either to protect by payment of pre-1974 real estate taxes or to bid in or on at the tax sales.

160. James Tedesco decided which Raymond Colliery parcels would be bid upon at the tax sales.

161. Representatives of IIT and Pagnotti Enterprises had discussed the possibility that independent parties might bid at the scheduled county tax sales.

162. By letters dated December 16, 1976, Allen Katz, IIT's in-house counsel, requested that that Lackawanna County Tax Claim Bureau and the Luzerne County Tax Claim Bureau, respectively, read to all prospective bidders at the tax sales that IIT, as of December 16, 1976, had a first mortgage of \$4,731,895, plus additions thereto of \$492,154, that notices of default had been issued, and that IIT as mortgagee might in its absolute discretion commence foreclosure proceedings.

163. It was apparent to IIT and Pagnotti Enterprises that the existence of

the IIT mortgages would deter third parties from bidding on Raymond Colliery and Blue Coal parcels scheduled for tax sale.

164. L. Robert Lieb and James Tedesco decided to pre-pay the taxes that were superior to the IIT mortgages prior to the date of the tax sales so that the tax sales would not divest the IIT mortgages.

165. The pre-November 26, 1973 real estate taxes constituted a lien on the property purportedly encumbered by the IIT mortgages prior to said mortgages.

166. On December 16, 1976, from the \$1,200,000 escrow account created as part of the December 15, 1976 mortgage sale contract, L. Robert Lieb, acting on behalf of IIT, paid \$447,786.13 to Lackawanna County on account of delinquent real estate taxes owed by Raymond Colliery for years prior to 1974.

167. L. Robert Lieb also paid \$30.00

on account of delinquent poor taxes levied against Raymond Colliery in 1930.

168. The payment of the pre-1974 realty taxes by IIT was an advance by IIT under a clause in the November 26, 1973 Note Purchase and Loan Agreement which gave it the right to pay delinquent taxes and add the amount paid to the lien of the mortgages.

169. The payment of \$447,786.13 related to all properties formerly owned by Raymond Colliery and advertised for tax sale by Lackawanna County except those properties as to which Pagnotti Enterprises had determined no bid would be made at the tax sale.

170. Counsel for IIT and Pagnotti Enterprises met with a Lackawanna County Commissioner and James Mancuso, the Director of the Lackawanna County Tax Claim Bureau, to explain how much IIT would bid

at the tax sale.

171. The officials of the Lackawanna County Tax Claim Bureau knew only the approximate amount of Raymond Colliery's pre-1974 Lackawanna County real estate tax liabilities.

172. On December 16, 1976, James Mancuso agreed to audit the amount of taxes due and refund any excess to Tabor Court Realty.

173. On December 16, 1976, L. Robert Lieb asked the Luzerne and Lackawanna County Tax Claim Bureaus to postpone the proposed tax sales without success.

174. The Lackawanna County tax sale began at 10:00 a.m. on December 17, 1976.

175. Norman Harris, local counsel for IIT, requested that the sale be adjourned until 3:30 p.m. on the ground that the principals involved in the sale also

needed to attend a similar sale in Wilkes-Barre held by the Luzerne County Tax Claim Bureau scheduled for 10:00 a.m. the same day.

176. The Lackawanna County tax sale was adjourned until 3:30 p.m.

177. At the December 17, 1976 scheduled Luzerne County tax sale, John Doran, Esq., announced that, as counsel for four petitioning creditors, he had filed an involuntary bankruptcy petition against Blue Coal Corporation and accordingly, that the Luzerne County tax sale was stayed by operation of law.

178. In response to the statement set forth above, L. Robert Lieb stated that as counsel for McClellan Realty he was prepared to bid in the Blue Coal properties at the advertised upset price and that he objected to any stay of the Luzerne County tax sale.

179. Merton Jones, local counsel for IIT and McClellan Realty, and Allen Katz of IIT joined in L. Robert Lieb's objection.

180. As a consequence of the Blue Coal bankruptcy filing on December 16, 1976, the tax sale scheduled by the Luzerne County Tax Claim Bureau to be held on December 17, 1976 did not take place.

181. At 3:35 P.M. the Lackawanna County tax sale was reconvened.

182. By the time of the December 17, 1976 Lackawanna County tax sale, counsel for IIT and Pagnotti Enterprises were satisfied that they had sufficient information to bid on the properties at the tax sale.

183. Because of the confused nature of the Lackawanna County tax sale records and the probable failure of the county to post all of the properties of Raymond

Colliery, counsel for IIT and Pagnotti Enterprises believed that the Lackawanna County tax sale would convey only color of title.

184. Prior to the bidding at the tax sale on Raymond Colliery's lands, Lackawanna County Solicitor James J. Ligi announced that IIT had a first mortgage on the tracts with a balance due of \$4,731,895, plus additions of \$44,368 and \$447,786.13 for the taxes paid by IIT on December 16, 1976 and that IIT had paid all 1973 and earlier delinquent property taxes.

185. The announcement of the existence of the IIT mortgages at the Lackawanna County tax sale was made to suppress bidding on Raymond Colliery's lands and to prevent injury to a purchaser who bought property without knowledge of the liens as well as to prevent a subsequent

attack upon the validity of the sale by such a purchaser because of such non-disclosure.

186. At the Lackawanna County tax sale, L. Robert Lieb on behalf of Tabor Court Realty submitted to the Lackawanna County Tax Claim Bureau a written bid for the aggregate upset sales price of the Raymond Colliery parcels, less the taxes allocable to certain coal-only properties for which no tender was made.

187. The written tax bid submitted by Tabor Court Realty stated that the bid was subject to audit of the Lackawanna County tax records, with any excess monies paid returnable to Tabor Court Realty and with any deficiency to be paid by Tabor Court Realty.

188. Mr. Ligi announced at the Lackawanna County tax sale that Tabor Court Realty had submitted a bid in the amount

of the upset price which would be approximately \$385,000 for the designated properties.

189. No other bids were made on any other Raymond Colliery lands at the tax sale.

190. Tabor Court Realty's bid of \$385,000 was accepted by Lackawanna County and L. Robert Lieb tendered a check in that amount to James J. Ligi.

191. The check for \$385,000 was drawn on the escrow account established pursuant to the terms of the December 15, 1976 mortgage sale contract.

192. Prior to the Lackawanna County tax sale, Norman Harris had prepared a tax sale deed covering the properties on which L. Robert Lieb intended to bid and had made arrangements with the county to have the deed executed immediately after the sale and to have the office of the

Recorder of Deeds stay open past the usual closing time so that the deed could be recorded immediately after the tax sale.

193. Immediately following the 1976 tax sale, and on the same day, the deed prepared by Norman Harris purporting to convey the lands purchased by Tabor Court Realty was executed and delivered by the Lackawanna County Tax Claim Bureau, as grantor, to Tabor Court Realty.

194. The tax deed was recorded immediately thereafter.

195. IIT wanted the tax sale deed recorded as promptly as possible in order to protect its interest in the event of an intervening bankruptcy proceeding.

196. James Tedesco and Hyman Green entered into an arrangement, the exact terms of which are not known to the Court, relating to the acquisition by

Tabor Court Realty of the Raymond Colliery and Blue Coal properties at the 1976 tax sales.

197. As a result of this agreement, Hyman Green did not take any steps to protect Raymond Colliery's lands from being sold at the county tax sales.

198. Hyman Green did not attend either the Lackawanna or the Luzerne County tax sales.

199. L. Robert Lieb, counsel for IIT, avoided any discussion with James Tedesco regarding whether an arrangement had been made with Hyman Green because L. Robert Lieb did not want to be charged with such knowledge.

200. As of December 17, 1976, the stock of Tabor Court Realty was held by L. Robert Lieb as trustee under the terms of the December 15, 1976 mortgage sale contract.



201. On December 20, 1976, James Milland, as president of the four borrowers, forwarded to Pagnotti Enterprises acknowledged "declarations of no set-off."

202. After the 1976 tax sale, the Lackawanna County Tax Claim Bureau determined that Tabor Court Realty had made aggregate overpayments on the upset prices in the amount of \$37,366 and refunded such sum to Tabor Court Realty.

2#3. The Lackawanna County Tax Claim Bureau also refunded to Tabor Court Realty the amounts of \$1,455.00 and \$116.00, which had been paid as duplicate purchase prices for parcels bought by Tabor Court Realty at the 1976 tax sale.

204. The \$116.00 duplicate payment was allocable to the December 16, 1976 tax payment made by IIT to satisfy the delinquent taxes which pre-dated IIT's

mortgages.

205. The checks for \$37,366, \$1,455 and \$116 were made payable to Tabor Court Realty.

206. No refund of the 1930 poor tax was made although the tax was not a lien on the lands at the time of the sale.

207. In accordance with Robert Lieb's instructions, the three checks refunded to Tabor Court Realty by the Lackawanna County Tax Claim Bureau were sent to the post office box for Morris Gelb's firm, Gelb & Myers.

208. Neither the Lackawanna County Tax Claim Bureau nor IIT nor James Tedesco distinguished between the overpayment of the December 16, 1976, redemption payment and the December 17, 1976, tax sale bid by Tabor Court Realty.

209. The Lackawanna County tax deed was not amended to reflect the purported

reduction of the sales price of Raymond Colliery's lands after the audit by the Lackawanna County Tax Claim Bureau.

210. None of the tax sale proceeds was paid to creditors whose liens were purportedly divested from the properties sold and none was paid to the holder of the mortgages.

211. The closing on the sale of the IIT mortgages to Pagnotti Enterprises or its nominee was scheduled for January 26, 1977.

212. Prior to and on the date of the January 26, 1977 closing, neither L. Robert Lieb nor James Tedesco had seen copies of the letters written in 1973 by Walter M. Strine, counsel for IIT, Bernard Jacobs, James Hillary, Charles Parente or Henry Greenwald to IIT concerning the details of the November 26, 1973 mortgage transaction.

213. Prior to and on the date of the January 26, 1977 closing neither James Tedesco nor L. Robert Lieb had seen the cash flow projections for the Raymond Group prepared in 1973 by John Streiker, the loan administrator at IIT involved with the 1973 mortgage transaction.

214. Prior to and on the date of January 26, 1977 closing of the mortgage sale contract L. Robert Lieb was unaware that Walter M. Strine had refused to furnish an opinion letter with respect to the "validity and enforceability" of the IIT mortgages as required by the Note Purchase and Loan Agreement executed November 26, 1973.

215. It is not standard practice in the real estate field for a lender to waive the right to an opinion letter from its own counsel.

216. During the period of December

15, 1976, through January 26, 1977, Richard Bishop and Morris Gelb further reviewed the IIT closing documents of November 26, 1973.

217. Prior to and on January 26, 1977 closing of the mortgage sale contract, counsel for Pagnotti Enterprises, Morris Gelb and Richard Bishop, did not investigate the use made of the loan proceeds received by the Raymond Group in 1973.

218. The closing of the sale to Pagnotti Enterprises or its nominee of the IIT debt and securities was held as scheduled on January 26, 1977 at the offices of Nogi, O'Malley and Harris in Scranton.

219. Until the moment of closing L. Robert Lieb had doubts about whether Pagnotti Enterprises would complete the transaction even though it would have to forfeit its \$600,000 deposit if the transaction were not closed.

220. At the January 26, 1977 closing Pagnotti Enterprises paid IIT \$3,600,000 for IIT's loans and securities.

221. At the closing Pagnotti Enterprises reimbursed IIT for its \$600,000 payment into the escrow account.

222. At the closing the IIT mortgages were assigned and delivered to McClellan Realty, the nominee of Pagnotti Enterprises.

223. At the closing Pagnotti Enterprises paid L. Robert Lieb \$100.00 for the stock of McClellan Realty and the stock of McClellan Realty was transferred to Pagnotti Enterprises.

224. At the closing Morris Gelb paid L. Robert Lieb \$100.00 for the stock of Tabor Court Realty and the stock of Tabor Court Realty was assigned to Loree Associates.

225. Loree Associates reimbursed

Morris Gelb \$100.00 for the payment for the stock of Tabor Court.

226. Loree Associates is a limited partnership owned 57.95% by individual members of the Pagnotti family, 22.05% by individual members of the Tedesco family and 20% by individual members of the Ventre family.

227. Louis Pagnotti, II, Sue Ventre and James Tedesco are general partners of Loree Associates. Children and grandchildren of Louis Pagnotti, Henry Ventre and James Tedesco are limited partners.

228. At the closing, L. Robert Lieb wrote a check to Pagnotti Enterprises for \$299,412.00 which was the balance in the escrow account created on December 15, 1976.

229. At the closing, the remaining November 26, 1973 closing binders were delivered to Pagnotti Enterprises by

Nogi, O'Malley and Harris, local counsel for IIT.

230. By January 26, 1977, Pagnotti Enterprises had paid a total of \$4,500,688 for the purchase of the IIT mortgages and the stock of Tabor Court Realty.

231. On January 26, 1977, the balance purported to be due on the aggregate of the four IIT loans was \$5,817,475.69.

232. Delinquent real estate taxes owed by Raymond Colliery to the City of Scranton for 1974, 1975, and 1976 were paid by McClellan Realty and not by the property owner, Tabor Court Realty.

233. McClellan Realty added the amount paid to the City of Scranton for Raymond Colliery's real estate taxes to the principal amount owed on the IIT loans.

234. McClellan Realty filed a proof

of claim as a secured creditor of the Blue Coal bankruptcy estate for the aggregate principal balance and interest purported to be due on the November 26, 1973 IIT loans, based upon the guarantee mortgage executed by Blue Coal to secure the same.

235. At no time has Tabor Court Realty paid real estate taxes to Lackawanna County.

236. During the period of January 26, 1977 through December 16, 1980, Tabor Court Realty made no interest or principal payments on the mortgage loans.

237. During the period of January 26, 1977 through December 16, 1980, McClellan Realty did not request Tabor Court Realty to make any payments of interest or principal on the loans.

238. During the period of January 26, 1977 through December 16, 1980, McClellan

Realty instituted noforeclosure proceedings as against the real properties purportedly owned by Tabor Court Realty.

239. During January 26, 1977 through December 16, 1980, neither McClellan Realty nor Tabor Court Realty had any business activity.

240. Lackawanna County personnel hindered the appraisers hired by the United States in connection with this litigation in their effort during 1980 to locate the properties sold at the 1976 tax sale.

241. Many, if not all, of the deeds issued by Raymond Colliery to purchasers in recent years had strip maps attached to them.

242. With the assistance of strip maps attached to the deeds, many, if not all, of the Raymond Colliery properties listed for tax sale in 1976 and iden-

tified in part or in whole by a function number could have been found by a qualified person conducting a title search.

243. In 1976, any competent title searcher exercising due diligence could have located all or substantially all of Raymond Colliery's lands advertised for tax sale by using the assessment records, grantors' and grantees' indices, aerial maps, and other maps and assessment records, all of which are public documents.

III. Discussion

A. Overview.

McClellan Realty and Pagnotti Enterprises claim that the IIT mortgages found fraudulent by this Court are valid in the hands of McClellan Realty. Pagnotti Enterprises, McClellan Realty's parent, was responsible for obtaining the assignment of the IIT mortgages to McClellan Realty. Therefore, Pagnotti Enterprises is the

entity whose knowledge and actions are to be tested.

The United States, the Trustee in Bankruptcy and the Commonwealth (hereinafter the Creditors) have asserted two theories in support of their contention that the IIT mortgages are invalid in the hands of McClellan Realty. The first is that Pagnotti Enterprises was not a bona fide purchaser of the mortgages and therefore purchased the mortgages subject to all outstanding claims and defenses of third parties. See 39 Pa.Cons.Stat. Sec. 359(1). The second is that the 1976 tax sale to Tabor Court Realty, the 1977 assignment of mortgages to McClellan Realty, and the transfers of stock of Tabor Court Realty and McClellan Realty to Pagnotti Enterprises and Loree Associates, two related entities, were made with an intent to hinder, delay or de-

fraud creditors within the meaning of section 357 of the Pennsylvania Uniform Fraudulent Conveyance Act. 39 Pa. Cons. Stat. Sec.357.

A. Bona Fide Purchaser Issue.

Under the Pennsylvania Uniform Fraudulent Conveyance Act (hereinafter "the Act"), a creditor whose claim has matured may set aside any conveyance or obligation found fraudulent as against that creditor. 39 Pa.Cons.Stat. Sec. 359(1). A subsequent purchaser of a fraudulent conveyance or obligation takes subject to the rights of creditors under the Act unless the subsequent purchaser is a "purchaser for fair consideration without knowledge of the fraud at the time of the purchase." 39 Pa.Cons.Stat. Sec. 359(1). For simplicity, such a subsequent purchaser will be called herein a "bona fide purchaser". The burden of proof on this

question rests on the alleged bona fide purchaser. *Cancilla v. Bondy*, 353 Pa. 249, 253, 44 A.2d 586 (1945).

Under the Act, Pagnotti Enterprises would attain the status of a bona fide purchaser only if it could establish both that it purchased the IIT mortgages for fair consideration and that it had no knowledge at the time of the purchase that the IIT mortgages were fraudulent conveyances. 39 Pa.Cons.Stat. Sec.359(1).

Fair consideration is given for a property or an obligation when "in exchange for such property or obligation, as a fair equivalent therefor and in good faith, property is conveyed or an antecedent debt is satisfied...." 39 Pa. Cons.Stat. Sec.353(a). The Defendants have argued that Pagnotti Enterprises paid IIT \$4,500,588 for the IIT mortgages

with a face value of \$5,817,475.69. The \$4,500,588 figure is the sum of \$600,000 paid on December 15, 1976 by Pagnotti Enterprises into the escrow account under the mortgage sale contract, \$3,600,000 paid by Pagnotti Enterprises at the January 26, 1977 closing of the mortgage sale contract, and \$600,000 reimbursed by Pagnotti Enterprises to IIT at the January 26, 1977 closing for IIT's December 15, 1976 payment into the escrow account, less \$299,412 refunded to Pagnotti Enterprises by L. Robert Lieb on January 26, 1977 as the balance remaining in the escrow account.

In our view, Pagnotti Enterprises paid \$4,047,786.13 as consideration for the IIT mortgages. This figure is the sum of the \$3,600,000 payment made by Pagnotti Enterprises to IIT on January 26, 1977 and the \$447,786.13 payment from the

escrow account of the pre-1974 delinquent real estate taxes of Raymond Colliery. Because the latter payment was necessary to protect the IIT mortgages from divestiture by the 1976 tax sale, it was part of the consideration paid for the mortgages. The remaining expenditures by Pagnotti Enterprises were for the purchase of the Raymond Colliery lands at the tax sale.

Despite their purported value of \$5,817,475.69, the IIT mortgages were in default and there was no probability, given the Blue Coal bankruptcy on December 16, 1976 and the dire financial condition of Raymond Colliery, that the mortgages would be paid in the near future. The \$4,047,786 payment by Pagnotti Enterprises for the IIT mortgages was a fair equivalent of the value of those mortgages.

The second issue under Section 359(1) of the Act is whether Pagnotti Enterprises purchased the IIT mortgages with the knowledge that they were fraudulent conveyances. In order for a purchaser of a fraudulent conveyance to take free of the rights of creditors, he must have neither actual nor constructive notice of the rights of creditors in the property purchased. *Cancilla v. Bondy*, 353 Pa. at 253, 44 A.2d at ____; *United States v. West*, 299 F. Supp. 661 (D. Del. 1969). Pagnotti Enterprises is charged with actual or constructive notice that the IIT mortgages were fraudulent conveyances under the Act only if Pagnotti Enterprises either knew or should have known (a) that the Raymond Group was rendered insolvent by the IIT mortgage obligations and that the IIT mortgages were not supported by fair consideration, 39 Pa.

Cons. Stat. Sec.354, or (b) that the IIT mortgage obligations were undertaken at a time when the Raymond Group was engaged in a business for which the capital remaining in its hands was unreasonably small, 39 Pa.Cons.Stat. Sec.355, or (c) that the IIT mortgages were delivered at a time when the Raymond Group believed it would incur debts beyond its ability to pay as they matured, 39 Pa. Cons. Stat. Sec.356, or (d) that the IIT mortgages were entered into with an intent to hinder or delay creditors of the Raymond Group, 39 Pa.Cons.Stat. Sec.357.

We conclude that Pagnotti Enterprises either knew or should have known that the IIT mortgages were not supported by fair consideration and rendered the Raymond Group insolvent. There were sufficient facts known to Pagnotti Enterprises which would have alerted a reasonably prudent

person to the likelihood that the IIT mortgages were defective and would thus have caused further investigation into the background of the IIT mortgages. Davis v. Hudson Trust Co., 28 F.2d 740, 743-44 (3d Cir. 1928). Moreover, a reasonable investigation would have revealed that the Raymond Group did not receive fair consideration for the IIT mortgages and was rendered insolvent by imposition of the same, thus making the IIT mortgages fraudulent conveyances within the meaning of Section 354 of the Act.

There were numerous facts known to Pagnotti Enterprises which would have caused a reasonable person to act with care before purchasing the IIT mortgages. First, on September 15, 1976, the mortgage notes were declared in default by IIT, the balances thereon were accelerated and payment thereof was demanded.

Second, on September 29, 1976 judgments were entered by IIT on the direct mortgages. Third, Pagnotti Enterprises was aware that the Raymond Group owed substantial overdue debts to the Internal Revenue Service, the Anthracite Health and Welfare Fund, the Commonwealth of Pennsylvania, and Lackawanna and Luzerne Counties. Indeed, the negotiations leading to the execution of the mortgage sale contract and the strategy used by Pagnotti Enterprises at the Lackawanna County tax sale were guided at least in part by the concern of IIT and Pagnotti Enterprises that creditors of Raymond Colliery and Blue Coal would force the corporations into bankruptcy before the tax sales could take place. Finally, by the time of the January 26, 1977 closing of the mortgage sale contract, Blue Coal had been placed into bankruptcy by its credi-

tors.

The Creditors have argued that the above circumstances alone would prevent Pagnotti Enterprises from possessing the status of a bona fide purchaser of the mortgages or at least would have put Pagnotti Enterprises on notice to make inquiry into the validity of the mortgages. There is modest support for this position. See Jones on Mortgages Sec.1069 (8th Ed. 19_) (which states that an assignee of a mortgage is not protected against equities of a third person if the assignment was taken after maturity of the debt secured). See also *Fuetsch v. Fahney*, 280 N.W.2d 687 (Wisc. 1939); *Hulet v. Denison*, 1 So. 2d 467 (Fla. 1941). Cf., 3 Williston, A Treatise on the law of Contracts Sec.438 at 259-60 (3d Ed. 1960) (the fact that a negotiable instrument is overdue does not give rise

The Defendants have argued that they were not on notice to inquire into the adequacy of the consideration received by or the solvency of the Raymond Group because the various documents assigned or obtained as part of the January 26, 1977 mortgages acquisition assured them that

after the conveyance).
 was left with unreasonably small capital is ipso facto a finding that the debtor 565 F.Supp. at 580 (finding of insolvency United States of America v. Gleneagles, meaning of 39 Pa.Cons.Stat. Sec.355. See capital and thus fraudulent within the in its hands was an unreasonably small business for which the property remaining when the Raymond Group was engaged in a executed by the Raymond Group at a time have known that the mortgages were view that Pagnotti Enterprises should For the same reasons, we are of the



See United States vs. Gleneagles, 565 F.Supp. at 564-65, 572, 578. Having this knowledge, Pagnotti Enterprises would have ascertained that the Raymond Group was rendered insolvent by the IIT loans. Thus, the dual requirements of section 354 are met, that the IIT mortgages were not supported by fair consideration and that the Raymond Group was rendered insolvent by the IIT mortgage obligations. Further, even assuming the financial statements themselves were not dispositive of the question of whether the Raymond Group was rendered insolvent by the IIT mortgages, they surely demonstrated the bleak nature of the Raymond Group's financial position in 1973 and the necessity for a further investigation by a purchaser of IIT's mortgages of the Raymond Group's solvency on November 26, 1973.



prepared by counsel for IIT, signed by James J. Durkin on November 27, 1973, and states that substantial portions of the IIT loan proceeds were disbursed by the mortgagors to Great American for purchase of the stock of Raymond Colliery. This document clearly shows that the Raymond Group did not receive fair consideration for the IIT obligations it undertook. This is one prong of the Section 354 test.

Moreover, a review of the index to the closing binders would have readily revealed to Pagnotti Enterprises that they contained the financial statements of all members of the Raymond Group between 1971 and June 30, 1973. These financial statements show that the Raymond Group had substantial liabilities, a poor earnings history and would have been unable to meet the IIT loan obligation.

Davis v. Hudson Trust Co., 28 F.2d 740, 743-44 (3d Cir. 1928). In this case, reasonable inquiry would have revealed that substantial portions of the IIT loan proceeds did not pass to the Raymond Group but were funneled through the Raymond Group to the sellers of the Raymond Colliery stock. In particular, the index to the closing documents which was in the possession of Pagnotti Enterprises referred to a document listed as "Letter to Chicago Title Insurance Company (November 27, 1973) re: application of loan proceeds"(emphasis added) and to the location of this document in the closing binders. The contents of the closing binders were either in the possession of or readily available to Pagnotti Enterprises shortly after October 20, 1976 and before January 26, 1977. The "Letter to Chicago Title Insurance Company" was



Once a subsequent purchaser of a mortgage is put on notice to inquire into a certain fact, he will be charged with all additional facts which a reasonably diligent inquiry would have disclosed.

been supported by fair consideration. fore, that the mortgages may not have proceeds of the IIT mortgages and, therefore, that the mortgages may not have received the Group may not actually have received the enterprises on notice that the Raymond This information alone put Pagnotti Enterprises on notice that the Raymond Group from IIT. received by the Raymond Group from IIT. use of the substantial monies purportedly have put it on notice to inquire into the by Pagnotti Enterprises would certainly In our view, the knowledge of these facts was attempting to liquidate its assets. having serious financial difficulties and IIT loans, that the Raymond Group was 1974, two months after the closing of the was also aware, at least as of January,



Raymond Colliery for their stock. We reach this conclusion for several reasons. First, the index to the IIT loan closing documents which was provided to Pagnotti Enterprises on October 20, 1976 and which was reviewed by representatives and officers of Pagnotti Enterprises shows on its face that the November 26, 1973 IIT loan was used in part for the purchase of the stock of the Raymond Group. The precise language of the index to Volume XII at item 1.22(n) is as follows: "Disclosure of the sources of all financings of the purchase price not being funded by IIT..."

Second, by October of 1976, if not earlier, James Tedesco knew that on November 26, 1973 the Raymond Group had become obligated for \$8,530,000 to IIT by mortgages of record. Third, James Tedesco, an officer of Pagnotti Enterprises



to constructive knowledge of the existence of collateral equities affecting the transferor's title); In re Locust Building Co., Inc., 299 F. 756, 762 (2d Cir. 1924). However, because Pagnotti Enterprises knew additional facts which more clearly related to the defects in the IIT mortgages, we need not decide whether the bankruptcy of Blue Coal, the default status of the mortgages and the obvious insolvency of the Raymond Group on December 15, 1976 and January 26, 1977 are suspicious circumstances sufficient to deprive Pagnotti Enterprises of the status of a bona fide purchaser and to put Pagnotti Enterprises on notice to inquire into the validity of the IIT mortgages.

Pagnotti Enterprises knew that some portion of the IIT loan proceeds were used to pay the prior shareholders of





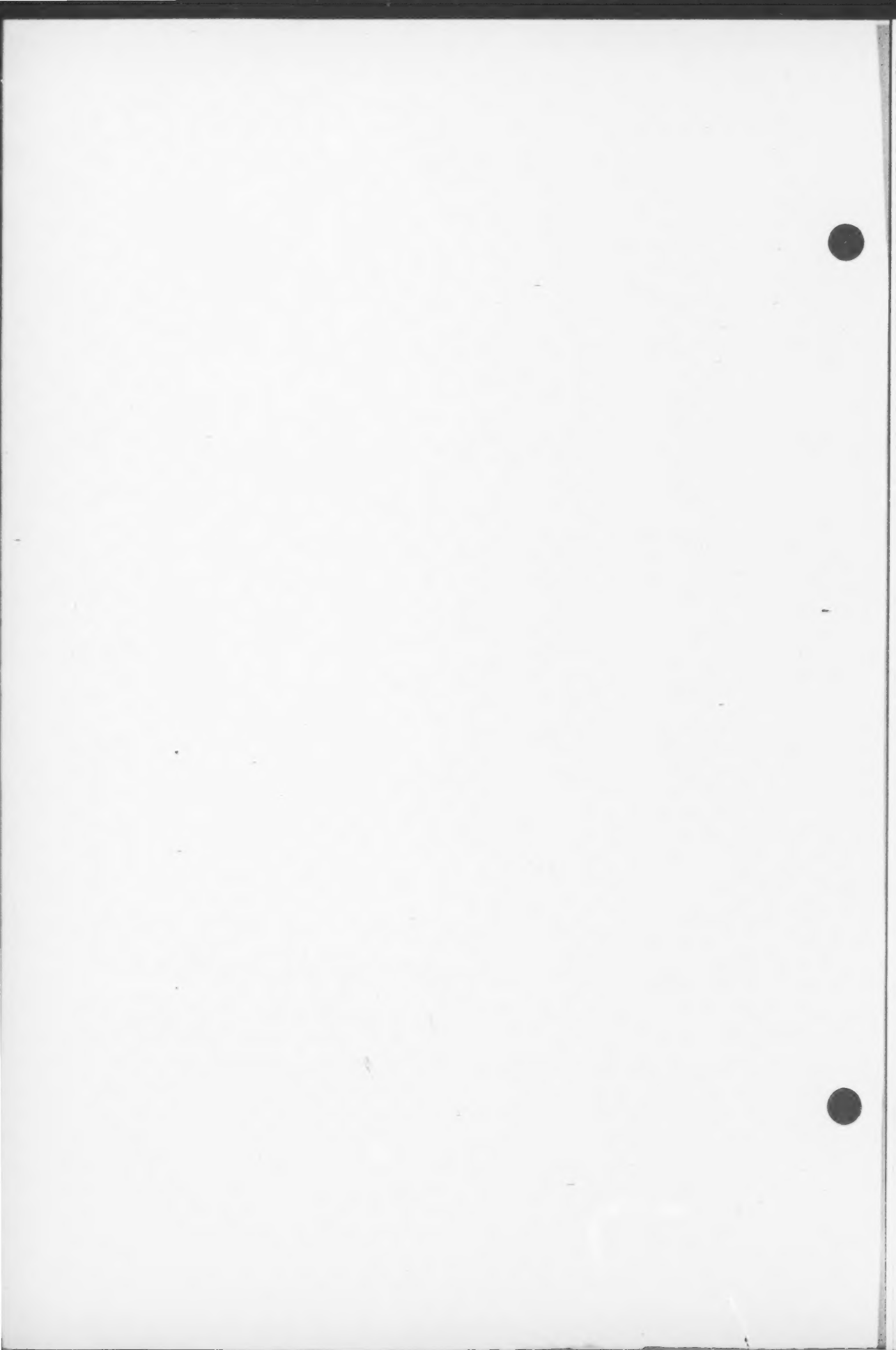
the IIT mortgages were valid. The Defendants point first to the fact that they obtained "Declarations of No Set-Off" from the debtors prior to purchasing the IIT mortgages. The declarations of no set-off would only protect Pagnotti Enterprises from defenses to the mortgages raised by the corporate debtors. Quigley vs. Breyer Corp., 362 Pa. 139, 142, 66 A.2d 286, 287 (1949); Fort Pitt Real Estate Co. vs. Schaefer, 96 Pa. Super. 497, 502 (1929).

Obtaining those declarations, therefore, did not eliminate the need to inquire further into the existence of equities in favor of other creditors of the Raymond Group. Moreover, we find it exceedingly odd that one of the declarations of no set-off was signed by James Millard as president of Blue Coal on December 20, 1976 which was after the

filing of the Blue Coal bankruptcy petition. Pagnotti Enterprises could not reasonably rely on a declaration of no set-off executed by a president of a company against which an involuntary bankruptcy petition has been filed.

Defendants also point to the fact that the mortgages were covered by title insurance. The Defendants argue that the existence of a title insurance policy excuses them from any requirement that they inquire into the validity of the mortgages except as to those matters excluded by the policy. This is a paralogism. The first defect in the Defendants' argument is that the title insurance policy did not cover the guarantee mortgages. Therefore, the policy could not reasonably be relied upon as evidence of the validity of the guarantee mortgages.

A review of the materials in the closing binders relating to the title insurance policy would have led Pagnotti Enterprises to the letter of November 27, 1973 signed by James Durkin to Chicago Title on the use of the IIT loan proceeds. The letter was prepared by counsel for IIT to inform Chicago Title of a potential defect in the mortgages to guard against a clause in the policy excluding from coverage "[d]efects,...or other matters... not known to [Chicago Title] and not shown by the public records but known to the insured claimant and not disclosed in writing ... to [Chicago Title]." This letter was notice to Chicago Title, and later to Pagnotti Enterprises, that the use of the IIT loan proceeds in the purchase of the stock of the Raymond Group made the mortgages potentially defective.



The Court questions the Defendants' assertion that Pagnotti Enterprises did not have actual knowledge of certain matters which would have led its officers to conclude that the IIT mortgages rendered the Raymond Group insolvent and that fair consideration was not received by the Raymond Group for the mortgages. In particular, representatives of Pagnotti Enterprises, during the course of this trial, repeatedly asserted that they relied primarily on the Chicago Title insurance policy when negotiating to purchase the IIT debts and securities. In our view, such a reliance would at a minimum have caused Pagnotti Enterprises to review every document listed in the closing index relating to the title insurance policy. Only two such documents were listed in the index -- the policy itself and the " Letter to Chicago Title

Insurance Company" from James Durkin. In our opinion, this latter document was likely read by representatives of Pagnotti Enterprises sometime before the January 26, 1977 closing of the mortgage sale contract and the reader was informed that the Raymond Group did not receive fair consideration for the IIT mortgage obligation.

Additionally, Pagnotti Enterprises, through its various coal producing affiliates, was the Raymond Group's largest competitor in the anthracite coal market and the two competitors dominated the market. The financial statements of the Raymond Group were contained in the 1973 closing binders and were properly indexed. Tedesco should have examined these financial statements. Further, Tedesco's knowledge of Durkin's activities in early 1974 relating to the sale of substantial



assets of the Raymond Group would have alerted him to the fact that the apparent massive infusion of capital in November, 1973 had not produced financially healthy mortgagors but had caused, instead, unhealthy, insolvent debtors. Companies related to Pagnotti Enterprises lent under the direction of Tedesco \$405,000 to the Durkins or to Great American Coal to assist in financing Great American's purchase of stock of Raymond Colliery. Moreover, on at least two occasions prior to the closing of the IIT loans, counsel for the Durkins, Henry Greenwald, sought from James Tedesco information needed by James Durkin for the closing of the IIT loan.

An additional fact in this case which indicates an unusually close relationship between the Durkins and James Tedesco is the suspicious "loan" of \$200,000 made on

July 16, 1973 by No. 1 Contracting Co. to James and Anna Jean Durkin and excessively secured by \$300,000 in cash. Tedesco admitted that this transaction was unique, that No. 1 Contracting had not made other loans, and that he had never heard of any other "loan" secured 150% by cash. The cash collateral was kept in a safe deposit box for over two years. James Tedesco allegedly accepted the cash collateral without questioning James Durkin as to its origin. There was certainly no economic reason behind the willingness of James Durkin and Pagnotti Enterprises to secrete the cash in this unprofitable manner for over two years. Further, we find it exceedingly odd that the Old Forge Bank at the instance of James Tedesco made an unsecured loan to the Durkins on the same date that No. 1 Contracting also through the offices of



James Tedesco made the loan excessively secured by cash to the Durkins. James Tedesco testified that he made the \$200,000 loan by No. 1 Contracting Co. because he saw an opportunity to earn for the company interest thereon. If that was his motive, why then did he not put the \$300,000 collateral at interest at least in negotiable short term U.S. governmental bonds where the risk could fairly be dismissed as negligible? No satisfactory explanation of this unique "loan" was given to the Court and we are not convinced that a full disclosure of the circumstances of the "loan" was made to the Court by Tedesco although directly requested of Tedesco by the Court while he was on the stand. This "loan" is neither fish nor fowl nor good red herring.

During the course of these various

contacts and given the natural curiosity one would have regarding the specifics of a sale of the stock of one's major competitor, we find incredible that representatives of Pagnotti Enterprises when dealing in 1973 with Durkin or his counsel did not request and receive information relating to the IIT financing. In short, we are not convinced that Pagnotti Enterprises did not have actual knowledge of the basic structure of the IIT mortgage transaction and its potentially defective nature.

Defendants contend that Pagnotti Enterprises became a purchaser of the IIT mortgages upon signing the December 15, 1976 mortgage sale contract and was not put on notice to inquire as to the validity of the mortgages until after that date. On December 15, 1976, it paid only \$600,000 which would have been insuffi-

cient to make it a bona fide purchaser of the IIT mortgages having a face amount of \$5,817,475.69. See 39 Pa.Cons.Stat. Sec. 353(a). Moreover, while we have found no Pennsylvania case on point, the law in other jurisdictions is that an individual is not a purchaser of a property until he has actually paid the purchase price or has become irrevocably bound to make payment therefor. E.g., 37 Am. Jur. 2d, Fraudulent Conveyances, Sec.154. The signing by Pagnotti Enterprises of the mortgage sale contract on December 15, 1976 did not irrevocably bind Pagnotti Enterprises to purchase the IIT mortgages. IIT would have been unable under the mortgage sale contract to obtain specific performance if Pagnotti Enterprises had failed to perform because the contract provided for liquidated damages in the amount of \$600,000 in the event that

Pagnotti Enterprises failed to purchase the mortgages. Pagnotti Enterprises did not become a purchaser of the IIT mortgages until January 26, 1977 when it paid the balance of the purchase price and was clearly put on notice prior to that date to inquire as to all the matters heretofore considered.

For all the foregoing reasons, we are of the view that Pagnotti Enterprises was not a "purchaser for fair consideration without knowledge" of the fact that the IIT mortgages were fraudulent conveyances within the meaning of Sections 354 and 355 of the Act at the time it purchased them. 39 Pa.Cons.Stat. Sec.359(1). While we have concluded that Pagnotti Enterprises either knew or should have known that the IIT mortgages were fraudulent within the meaning of Sections 354 and 355 of the Act, we believe Pagnotti

Enterprises neither knew nor should have known that the IIT mortgage obligation was incurred at a time when the Raymond Group believed it would incur debts beyond its ability to repay as they matured. 39 Pa. Cons. Stat. Sec. 356. In this Court's earlier opinion, we concluded the IIT mortgages were fraudulent within the meaning of Section 356 of the Act in part because James Durkin, the president of the Raymond Group, knew that the IIT mortgages and the burdensome provisions in the Note Purchase and Loan Agreement relating to the required principal payments of proceeds from the sale of surplus lands would render the Raymond Group unable to pay debts arising in the ordinary course of its business. The intentions of James Durkin on November 26, 1973 and all of the information he had when he purchased the stock of Ray-

mond Colliery were probably not known to Pagnotti Enterprises on January 26, 1977, nor were there any facts known to Pagnotti Enterprises which would have led it further to investigate in an attempt to determine the actual intent of James Durkin on November 26, 1973. Therefore, Pagnotti Enterprises neither knew nor should have known that the IIT mortgages were fraudulent within the meaning of Section 356 of the Uniform Fraudulent Conveyance Act.

We further conclude that Pagnotti Enterprises neither knew nor should have known that the IIT mortgages were delivered with an intent to hinder or delay the Raymond Group's many creditors within the meaning of Section 357 of the Act. The Court, in its earlier opinion, concluded that IIT and the Raymond Group were aware that the 1973 transaction was

not supported by fair consideration and that they were aware that, as a result of the IIT mortgages, the Raymond Group would be unable to meet its other very substantial financial obligations. The Court further concluded, based on the knowledge of these matters possessed by IIT and the Raymond Group, that they intended to hinder and delay the collection efforts of the Raymond Group's numerous and very substantial unsecured creditors. The Court therefore determined that the IIT mortgages were fraudulent within the meaning of section 357 of the Act.

However, all the documentation and facts which led the Court to reach these conclusions were not in the possession of Pagnotti Enterprises when it purchased the mortgages. Much of the documentation consisted of correspondence from IIT's

counsel and a cash flow chart for Blue Coal drafted by a loan administrator at IIT contained in filing cabinets at IIT's New York offices. While the contents of these cabinets were available for review by Pagnotti Enterprises, Pagnotti Enterprises had no reason to review these voluminous documents for evidence of an intent on the part of IIT to hinder or delay Raymond Group creditors and did not act unreasonably in failing to do so. We conclude, therefore, that Pagnotti Enterprises neither knew nor should have known that the IIT mortgages were delivered with an intent to hinder or delay the creditors of the Raymond Group in violation of 39 Pa.Cons.Stat. Sec.357.

C. Fraudulent Conveyance Theory.

The Creditors also assert that the scheme embodied in the December 15, 1976 mortgage sale contract whereby the lands

of Raymond Colliery were permitted to be sold at the 1976 Lackawanna County tax sale to Tabor Court Realty, the IIT mortgages were sold to McClellan Realty, and the stock of both Tabor Court Realty and McClellan Realty were sold to related entities of Pagnotti Enterprises was a fraudulent conveyance within the meaning of Section 357 of the Pennsylvania Uniform Fraudulent Conveyances Act. 39 Pa.Cons.Stat. Sec.357. Section 357 of the Act provides: "Every conveyance made and every obligation incurred with actual intent, as distinguished from intent presumed in law, to hinder, delay, or defraud present or future creditors, is fraudulent as to both present and future creditors."

We have no doubt that the strategy agreed upon by Pagnotti Enterprises and IIT embodied in the December 15, 1976

mortgage sale contract was to obtain the lands of Raymond Colliery and Blue Coal free and clear of the claims of other creditors. In addition, Pagnotti Enterprises and IIT were aware that, by permitting Raymond Colliery and Blue Coal lands to be sold at county tax sale, these companies would be stripped of their most valuable assets and their creditors would be left without any possibility of payment. Nonetheless, we are not convinced that the intentional fraud provisions in the Uniform Fraudulent Conveyances Act cover situations where persons act to hinder the collection efforts of creditors of third parties. Furthermore, in our view, IIT and Pagnotti Enterprises simply took advantage of the Pennsylvania law relating to the effect of county tax sales. While the liens of other creditors were purportedly

discharged from Raymond Colliery's lands by the 1976 Lackawanna County tax sale and while Raymond Colliery was impoverished to the detriment of its many creditors, neither IIT nor Pagnotti Enterprises had any obligation to protect other creditors by enjoining the tax sales or failing to participate in the Lackawanna County sale. *David Oil Co. v. Fogle*, 354 Pa. 150, 153, 47 A.2d 209, 210 (1946).

The United States has cited several cases which indicate that use of a tax sale to commit a fraud on one's creditors is an intentional fraud within the meaning of the Uniform Fraudulent Conveyance Act. See *Smart v. Baroni*, 360 Pa. 296, A.2d (1948); *Pepe v. Mildred Bean*, 14 Fay. Leg. 133 (1951); *Roeting v. County of Lancaster*, 401 A.2d 580 (Pa. Comwlth., 1979). However, all cases cited by the

United States involve situations where the debtor itself conspired with another party to use a foreclosure sale or tax sale to sell the property and discharge other liens. In this case, while there was some hint in the evidence that Pagnotti Enterprises was conspiring with Hyman Green to use the Luzerne and Lackawanna tax sales to put the lands of Raymond Colliery and Blue Coal in the hands of Pagnotti Enterprises at a bargain price, and while it is extremely odd that Green did not appear at the tax sale and simply vanished without any payment, the existence of this conspiracy has not been proven by clear and convincing evidence. *Finberg v. Burkhardt*, 239 Pa. 519, 86 A.1062 (1913). *Cloud vs. Markle*, 186 Pa. 614, 40 A. 811 (1898) *Miners Savings Bank of Pittston v. United States*, 110 F. Supp. 563, 568 (M.D. Pa. 1953). We

therefore decline to determine that the actions of Pagnotti Enterprises relating to the December 15, 1976 mortgage sale contract constitute intentional fraud within the meaning of section 357 of the Act.

IV. Conclusions of Law.

1. The Lackawanna and Luzerne county real estate taxes which pre-dated the November 26, 1973 IIT mortgages constituted a prior lien on the lands of the Raymond Group.

2. Pagnotti Enterprises, on January 26, 1977, was not a purchaser for fair consideration without knowledge that the IIT mortgages were fraudulent conveyances under 39 Pa.Cons Stat. Secs. 354 and 355.

3. The Lackawanna County tax sale of lands of Raymond Colliery on December 17, 1976 and the subsequent tax deed was wholly defective and did not transfer

title to said lands to Tabor Court Realty.

4. The Lackawanna County tax sale of the lands of Raymond Colliery on December 16, 1980 and the subsequent tax deed was wholly defective and did not transfer title to said lands to Gleneagles Investment Co. Inc.

An appropriate order in accordance with this opinion will be entered in due course after the conclusion of the trial.

/s/
MUIR, U. S. District Judge

Dated: September 13, 1983

UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF PENNSYLVANIA

UNITED STATES OF :
AMERICA, :
 :
Plaintiff : Civil No. 80-1424-
 :
vs. : (Reassigned to
Judge : Muir 3/5/81)
 :
GLENEAGLES INVESTMENT:
CO., INC., et al., :
 :
Defendants :

OPINION

MUIR, District Judge.

I. Introduction.

The United States has sought in this litigation to set aside as fraudulent conveyances mortgages on the lands of Raymond Colliery (hereinafter the IIT mortgages) and to foreclose on tax liens against Raymond Colliery and its parent, Great American Coal Company, free and clear of the IIT mortgages. Those mortgages were delivered by Raymond

Exhibit "C"

Colliery on November 26, 1973 to Institutional Investors Trust (IIT) and assigned by IIT onto Defendant McClellan Realty. The United States has also sought in this lawsuit to set aside the 1976 and 1980 tax sales of the lands of Raymond Colliery by Defendant Lackawanna County.

Blue Coal and Glen Nan are bankrupt subsidiaries of Raymond Colliery and their assets are also encumbered by the IIT mortgages. (Raymond Colliery and its subsidiaries will be called hereinafter "the Raymond Group"). The Defendant Trustee in Bankruptcy for Blue Coal and Glen Nan filed a cross-claim in which he sought, inter alia, to set aside the IIT mortgages. The United States and the Trustee will be hereinafter called "the Creditors." The Defendant Commonwealth of Pennsylvania is not within the group classed as Creditors because it filed no

cross-claim but it is a creditor of Raymond Colliery and has participated in this litigation as though it were a cross-claim plaintiff.

This lawsuit has been the subject of two earlier opinions by the Court. In the first opinion, the Court concluded that the IIT mortgages were fraudulent conveyances within the meaning of Secs. 354, 355, 356, and 357 of the Pennsylvania Uniform Fraudulent Conveyance Act, 39 Pa.Stat. Sec. 351, et seq (hereinafter sometimes referred to as "the Act"). United States vs. Gleneagles Inv. Co., Inc., 565 F.Supp. 556, 585-86 (M.D. Pa. 1983) (hereinafter Gleneagles -I.) In the second opinion, the Court concluded that Pagnotti Enterprises which purchased the IIT mortgages and caused the assignment thereof to its subsidiary, McClellan Realty, was not a purchaser of the IIT

mortgages for fair consideration without knowledge that they were fraudulent conveyances. United States vs. Gleneagles Inv. Co., Inc., 571 F.Supp. 935, 958 (M.D. Pa. 1983) (hereinafter Gleneagles II). We also concluded in Gleneagles II that the Lackawanna County tax sales of the lands of Raymond Colliery in 1976 and 1980 and the consequent tax deeds were void and ineffective to transfer title to the purchasers at those tax sales. Id.

The Creditors also asserted claims against the Gillen and Cleveland Defendants, former shareholders of Raymond Colliery who were found liable in Gleneagles I. After that finding, the United States, the Trustee and the Commonwealth of Pennsylvania entered into settlement agreements with the Gillen and Cleveland Defendants relating to this and other litigation. Under those settlements the

Cleveland Defendants paid \$5,500,000 and the Gillen Defendants paid \$600,000 in satisfaction of all claims asserted against them in this litigation and the other litigation. The Court dismissed the Gillen and Cleveland Defendants as parties to this lawsuit pursuant to those settlement agreements.

Below are the Court's findings of fact, opinion and conclusions of law with respect to the priority and validity of liens on the lands of Raymond Colliery.

II. Findings of Fact.

1-167 The findings of fact in Glen-eagles I are incorporated herein by reference.

168-410. The findings of fact in Gleneagles II are incorporated herein by reference.

411. On November 26, 1973, Thomas Gillen received \$1,675,000 from Great

American Coal and a note payable to his order by the Raymond Group for \$125,000 in payment for his stock in Raymond Colliery.

412. On November 26, 1973, John Gil-
len received \$1,675,000 from Great Ameri-
can and a note payable to his order by
the Raymond Group for \$125,000 in payment
for his stock in Raymond Colliery.

413. On November 26, 1973, the Cleve-
land group of shareholders received
\$3,350,000 from Great American and notes
payable to their order by the Raymond
Group for \$250,000 in payment for their
stock in Raymond Colliery.

414. Judgments were confessed on the
notes described in Paragraphs 411, 412,
and 413 on June 16, 1975.

415. No. 1 Contracting Company and
Old Forge Bank lent money to James J.
Durkin to assist him in acquiring the

stock of Raymond Colliery and these loans were the only loans from third parties for such purpose which were not disclosed by Durkin to IIT in connection with his loan application to IIT.

416. During the period from November 26, 1973 through April, 1976, the financial condition of the Raymond Group worsened.

417. During the period from November 26, 1973 through April, 1976, Raymond Colliery, Blue Coal, Olyphant Associates, and Glen Nan paid to IIT a total of \$4,589,640 in principal and interest on the IIT mortgages.

418. On December 16, 1976, L. Robert Lieb on behalf of IIT paid to the Commonwealth of Pennsylvania \$44,368.74 in delinquent taxes owed by Raymond Colliery.

419. On December 16, 1976, L. Robert

Lieb on behalf of IIT paid to the City of Scranton \$11,122.25 in delinquent real estate taxes owed by Raymond Colliery for years prior to 1974.

420. In April, 1977, McClellan Realty paid \$23,179.36 to the City of Scranton for delinquent real estate taxes due from Raymond Colliery for the years 1974, 1975 and 1976.

421. The above payment by McClellan Realty was added to the lien of the IIT mortgages.

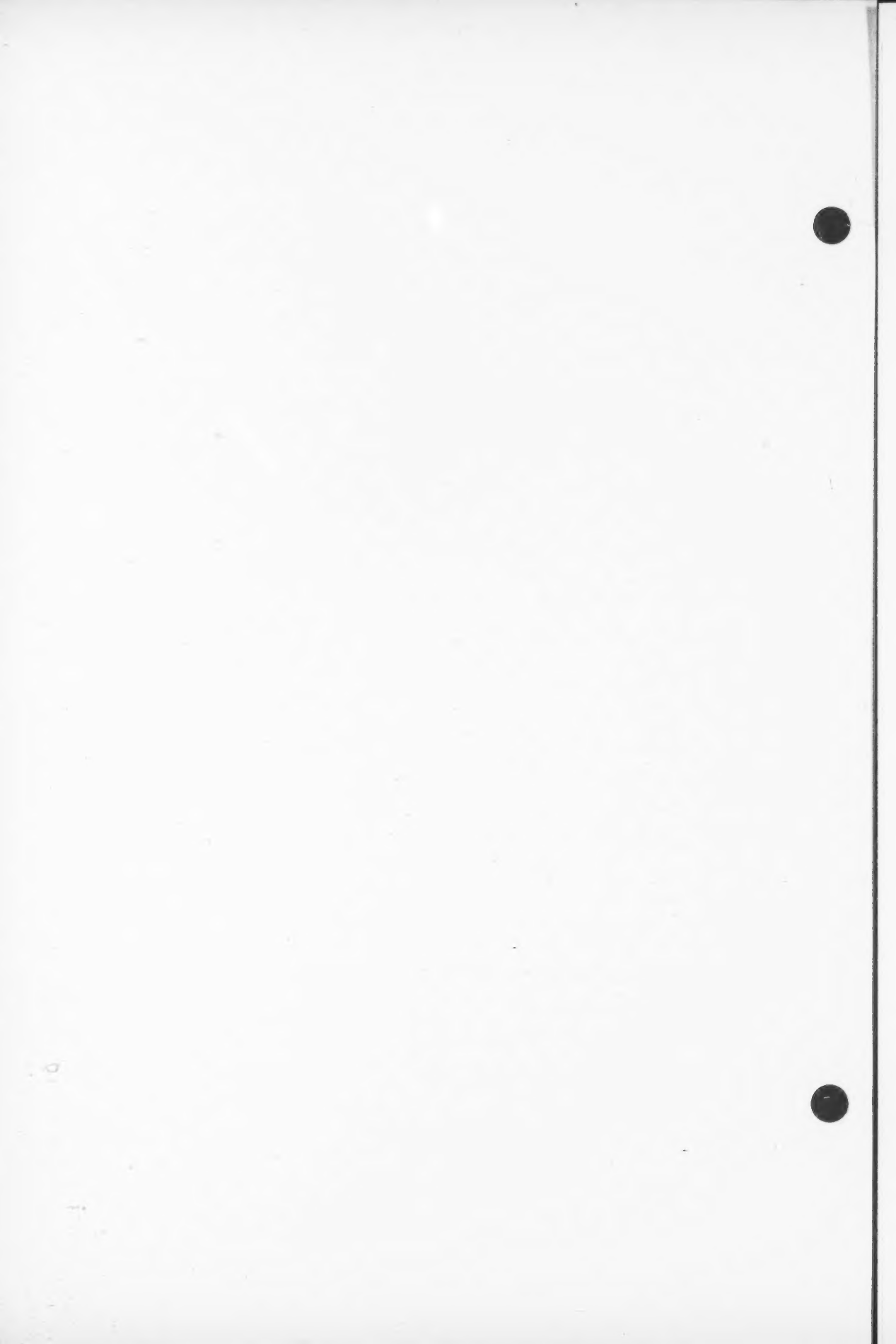
422. On December 12, 1977, Joseph Solfanelli hand-delivered to Hyman Green a notice that McClellan Realty intended to sell at one or more private sales held on or after February 12, 1978 the following collateral given by the debtors to secure the IIT loans:

a. the capital stock of Great American Coal Co.

b., the capital stock of Raymond Colliery

- c. accounts
- d. contract rights
- e. general intangibles
- f. goods
- g. inventory
- h. equipment
- i. culm
- j. silt
- k. refuse banks
- l. the contract rights described in the assignments of leases, operating and distribution agreements, and
- m. the contract rights under a November 26, 1973 agreement with Susquehanna Coal Co.

423. McClellan Realty foreclosed on its security interest in Raymond Collier-



y's equipment, culm, silt, contract rights, accounts, and other personalty in a private sale conducted on or about February 28, 1978 and bought in the same.

424. On or about February 28, 1978, James Tedesco, on behalf of McClellan Realty, and Louis Pagnotti, on behalf of Loree Associates, executed a contract whereby McClellan Realty purported to sell all the assets described in Paragraph 422(c) through (k) to Loree Associates for \$50,000.

425. No schedule of the specific assets purported to be sold to Loree Associates was prepared.

426. The assets purported to be foreclosed upon and sold by McClellan Realty to Loree Associates were not advertised for sale.

427. The assets purported to be foreclosed upon and sold by McClellan Realty

to Loree Associates were not offered for sale to any person or entity not affiliated with Pagnotti Enterprises.

428. The purported sale and purchase of the equipment and other assets was not recorded on the books of Loree Associates or McClellan Realty until May, 1983 which was six months after the start of this trial.

429. To record the \$50,000 payment from Loree Associates, McClellan Realty credited the 11T loan principal balance with \$50,000 and Tabor Court increased its liabilities by \$50,000, presumably to Loree Associates.

430. The stock of Raymond Colliery was foreclosed upon by McClellan Realty and sold for \$1.00 at a private sale on October 6, 1978 to Joseph Solfanelli as Trustee for the Pagnotti Group.

431. In each of the aforesaid fore-

closure sales McClellan Realty bid in the collateral in its own name or the name of its nominee, Joseph R. Solfanelli.

432. McClellan Realty did not give notice of the proposed private sale to the Trustee in Bankruptcy for Blue Coal, one of the debtors to McClellan Realty, or to any of the guarantors of Raymond Colliery's debt.

433. The only person or entity given notice of the private sales was Hyman Green.

434. McClellan Realty did not secure appraisals for any of the collateral which it sold at the private sales.

435. On December 16, 1980, a second tax sale of the lands of Raymond Colliery was held by the Lackawanna County Tax Claim Bureau.

436. At the December 16, 1980, tax sale Joseph Solfanelli, acting on behalf

of Gleneagles Investment Co. (hereafter Gleneagles), a corporation yet to be formed, and others successfully bid on the lands of Raymond Colliery.

437. Solfanelli tendered to the Lackawanna County Tax Claim Bureau his personal check in the amount of \$612,239.56 in payment of the bid price.

438. Solfanelli bid \$5,394.09 more than the advertised upset bid price.

439. On January 8, 1981, Gleneagles was incorporated under Pennsylvania law with Joseph Solfanelli as the sole shareholder.

440. On January 23, 1981, the Lackawanna County Tax Claim Bureau returned to Solfanelli his personal check for \$612,239.56 and accepted Gleneagles' check in the amount of \$535,290.39 in its stead.

441. In connection with the 1980 tax

sale, Gleneagles also paid 1980 school taxes to the Lackawanna County Tax Claim Bureau in the amount of \$93,935.04.

442. The lands of Raymond Colliery were purportedly transferred directly to Gleneagles by the Lackawanna County Commissioners by deed of April 15, 1981.

443. Officers and agents of the Pagnotti Defendants were also agents and controlling stockholders of Raymond Colliery and at least one officer of Raymond Colliery was also an agent of the Pagnotti Defendants at the time of the Lackawanna County 1930 tax sale.

444. The officers and agents of the Pagnotti Defendants who were at that time agents and controlling stockholders of Raymond Colliery did not act in good faith with reference to the creditors of Raymond Colliery when they attempted to divest the creditors' liens by running

the lands of Raymond Colliery through the Lackawanna County 1980 tax sale.

445. The Lackawanna County Tax Claim Bureau return to the Court of Common Pleas of Lackawanna County stated that Gleneagles had purchased the Tabor Court properties for \$629,225.43, the total of the two Gleneagles payments described in paragraphs 440 and 441.

446. On or about June 23, 1981, Joseph Solfanelli, on behalf of Gleneagles, paid to the Lackawanna County Tax Claim Bureau the \$5,394.09 described in Paragraph 438.

447. The Commonwealth of Pennsylvania holds liens on the lands of Raymond Colliery reflecting unpaid corporate taxes owed by Raymond Colliery in the following amounts:

1

Fiscal Year Ending	Tax	Interest to 6/30/83	Total due 6/30/83
6/30/69	\$18,085	\$14,873	\$32,958
6/30/70	19,223	14,655	33,878
6/30/71	16,038	11,265	27,303
6/30/72	36,542	23,475	60,017
6/30/74	1,738	907	2,645
6/30/75	30,131	13,928	44,059
6/30/75	410,381	189,701	600,082
6/30/75	17,343	8,017	25,360
6/30/76	193,242	77,264	270,506
6/30/77	193,242	65,739	258,981
6/30/78	193,242	54,496	247,738
6/30/79	193,242	42,911	236,153
6/30/80	<u>217,982</u>	<u>35,138</u>	<u>253,120</u>
Totals	\$1,540,431	\$552,369	\$2,092,800

448. The Commonwealth tax lien for fiscal year ending June 30, 1974 in the principal amount of \$1,738.00 and the tax liens for fiscal year ending June 30,

1975, in the principal amounts of \$30,131.00 and \$410,381.00 were filed between April 13, 1976 and January 27, 1977.

449. The remaining Commonwealth tax liens were filed on June 11, 1982 and July 12, 1983.

450. Raymond Colliery filed tax returns with the Commonwealth for the fiscal years ending June 30, 1969 through June 30, 1975.

451. No corporate tax returns were filed by Raymond Colliery with the Commonwealth for the fiscal years ending June 30, 1976 through June 30, 1980.

452. On June 11, 1982, the Commonwealth made estimated settlements of corporate taxes owing from Raymond Colliery for fiscal years ending June 30, 1976 through June 30, 1980.

453. The estimated settlements de-

scribed in the preceding paragraph were reviewed for substantive accuracy by both the Commonwealth of Pennsylvania Department of Revenue and Department of the Auditor General.

454. Raymond Colliery sought no review of the estimated settlements described in Paragraph 452.

455. The United States holds liens on the lands of Raymond Colliery reflecting unpaid corporate income taxes owed by Raymond Colliery in the following amounts:

(Ed. Note: Because of page format, the following table is not in the form of the original typewritten opinion handed down by Judge Muir.)

Fiscal Year Ending	Tax and Lien Fees	Penalties and Interest due to 12/31/83	Total due 12/31/83
--------------------	-------------------	--	--------------------

1966	\$35,799.52	\$1,444.08	\$37,276.35
------	-------------	------------	-------------

32.75

1967	96,861.44	1,629.30	98,490.74
------	-----------	----------	-----------

1968	1,125,650.72	897,350.42	2,023,033.89
	32.75		
1969	478,253.23	664,441.00	1,142,726.98
	32.75		
1971	218,269.92	273,267.21	491,569.88
	32.75		
1972	32.75	19,939.65	19,972.40
1973	16,800.00	21,774.49	38,607.24
	32.75		
Totals	\$1,971,831.33	\$1,879,846.15	\$3,851,677.48

456. The United States made an assessment on September 17, 1973 for corporate income taxes owed by Raymond Colliery for fiscal year ending June 30, 1967 in the principal amount of \$44,667.06.

457. The United States made an assessment on September 17, 1973 for cor-

porate income taxes owed by Raymond Colliery for fiscal year ending June 30, 1968 in the principal amount of \$827,765.85.

458. The remaining federal corporate income taxes owed by Raymond Colliery and listed in paragraph 455 were assessed between April 3, 1979 and April 22, 1981.

459. The United States holds liens against the lands of Raymond Colliery reflecting unpaid corporate income taxes owed by Great American in the following amounts:

Fiscal Year Ending 6/30/75	Tax and Lien Fees	Interest and Penalties through 12/31/83	Total due 12/31/83
\$2,244,670.75		\$2,615,445.43	\$4,860,148.43

8.50

23.75

460. The corporate income taxes owed by Great American and listed in Paragraph 459 were assessed between July 30, 1979

and August 25, 1980.

461. Notices of federal tax liens for the taxes described in Paragraphs 455 and 459 were filed and refiled.

462. The amounts claimed by McClellan Realty to be due as of December 31, 1983 on the direct mortgages assigned by IIT to McClellan Realty, including principal and interest through October 31, 1983, are:

Raymond Colliery	\$7,252,508.60
Blue Coal	9,756,410.06
Olyphant Associates	155,203.96
Glen Nan, Inc.	<u>155,203.96</u>
Total	\$17,319,326.58

463. The above amounts claimed by McClellan Realty to be due on the direct mortgages do not include additions for attorney fees or late fees.

464. The above amounts claimed by McClellan Realty to be due on the direct

mortgages include the following payments of real property taxes which have been added to the liens of the mortgages:

Raymond Colliery \$502,176.85 paid on
December 16, 1976 by
L. Robert Lieb, Trustee,
to Lackawanna County Tax Claim
Bureau

Blue Coal \$80,303.18 paid by
IIT to Luzerne County
Tax Claim Bureau.

465. Lackawanna County through its Tax Claim Bureau holds liens in the aggregate amount of \$192,582.88 against 129 parcels of Raymond Colliery's lands representing unpaid county, school and borough taxes due from Raymond Colliery for years 1981 and 1982.

466. The lands to which the Lackawanna County liens attach are located in the City of Scranton, the Boroughs of Archbald, Blakely, Jermyrn, Jessup, Mayfield and Taylor, and the Townships of Carbon-

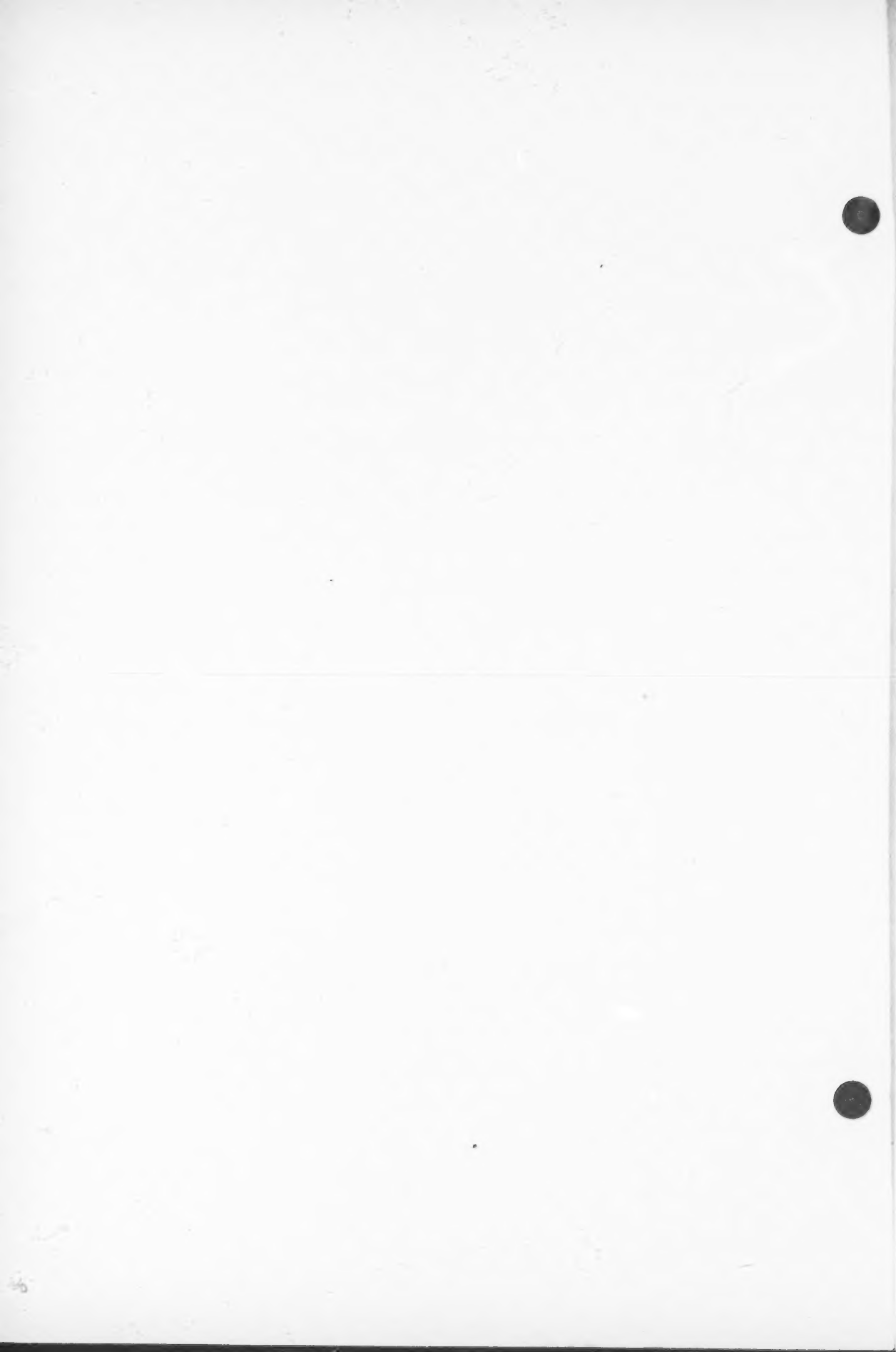
dale and Fell.

467. The Scranton Sewer Authority holds liens in the aggregate amount of \$62,929.50 against 34 parcels of Raymond Colliery's lands representing unpaid sewer assessments due from Raymond Colliery between September 27, 1969 and December 29, 1972.

468. The Scranton Sewer Authority also claims a lien in an unspecified principal amount against a Raymond Colliery parcel located at 326-328 Charles Street, Scranton, representing an unpaid sewer assessment, said lien being filed December 2, 1969.

469. The lands to which the Scranton Sewer Authority liens attach are located in the City of Scranton.

470. The Scranton Sewer Authority liens were filed between December 12, 1969 and June 26, 1973.



471. The Borough of Olyphant holds liens in the aggregate amount of \$1461.34 against 4 undesignated parcels of Raymond Colliery's lands located in the Borough of Olyphant representing unpaid paving liens.

472. The Borough of Olyphant liens were filed on November 15, 1983.

473. The Lackawanna River Basin Sewer Authority holds liens in the aggregate amount of \$109,695.25 against 65 parcels of Raymond Colliery's land representing unpaid sewer assessments due from Raymond Colliery and Tabor Court for years unspecified by the parties.

474. The lands to which the Lackawanna River Basin Sewer Authority liens attach are located in the Boroughs of Archbald, Blakely, Jermyn, Jessup, Mayfield and Throop and in the Townships of Carbondale and Fell.

475. The Lackawanna River Basin Sewer Authority liens were filed between January 17, 1975 and August 1, 1977.

476. The Borough of Taylor holds a lien against Raymond Colliery in the principal amount of \$1,000.00 representing unreimbursed expenses incurred by the Borough of Taylor when demolishing and removing a dangerous structure on July 15, 1976 situated on a Raymond Colliery parcel located in the Borough of Taylor.

477. The Borough of Taylor lien was filed on December 15, 1976.

478. The Estate of William R. Henkelman holds a lien in the aggregate principal amount of \$3,350.00 representing an unpaid arbitrators' award entered August 30, 1977 against Raymond Colliery in the case of William R. Henkelman vs. Raymond Colliery Co., Inc., No. 547, January Term, 1976 (Court of Common Pleas, Lack-



awanna County).

479. The Cleveland Defendants paid by cash a total of \$5.5 million in settlement of this lawsuit and other related lawsuits. Of that amount, \$3,000,000.00 was agreed by the parties to the settlement to be in payment of Raymond Colliery's debts, \$2,430,000.00 was agreed by the parties to the settlement to be in payment of Blue Coal's debts, and \$70,000.00 was agreed by the parties to the settlement to be in payment of Glen Nan's debts.

480. The Gillen Defendants paid a total of \$600,000.00 in settlement of this lawsuit and other related lawsuits. Of that amount, \$330,000.00 was agreed by the parties to the settlement to be in payment of Raymond Colliery's debts; \$262,000.00 was agreed by the parties to the settlement to be in payment of Blue



Coal's debts, and \$8,000.00 was agreed by the parties to the settlement to be in payment of Glen Nan's debts.

481. As part of the settlements the Gillen and Cleveland Defendants agreed not to seek recovery on the notes mentioned in Paragraphs 411, 412, and 413.

III. Discussion.

On November 26, 1983, Raymond Colliery, Blue Coal, Glen Nan and Olyphant Associates each delivered a direct mortgage on its lands to IIT. On the same date these companies and all of the other companies in the Raymond Group delivered mortgages to IIT as part of their guarantee of the entire loan by IIT. The first main issue before the Court is what protection, if any, should be accorded the IIT direct mortgages in the hands of McClellan Realty which asserts that the direct mortgages on the lands of the

Raymond Group are valid either in part or in their entirety as against the Creditors. McClellan Realty has made no argument that the IIT guarantee mortgages executed by each member of the Raymond Group are valid against the Creditors. Subsumed within the first issue is the question of whether McClellan Realty and other related corporations are entitled to liens for taxes paid on behalf of Raymond Colliery, some of which taxes were added to the lien of the IIT mortgages.

We note that our prior findings relating to Pagnotti Enterprises are applicable to its subsidiary, McClellan Realty, to whom Pagnotti Enterprises directed the mortgages to be assigned. For purposes of determining the rights of McClellan Realty vis a vis the Creditors, McClellan Realty's status is identical to that of

Pagnotti Enterprises.

The second main issue before the Court is the priority to be accorded the various liens, including the IIT direct mortgage on the lands of Raymond Colliery. The Court is not concerned with the priority of liens, including that of the IIT direct mortgages, on the lands of Blue Coal and Glen Nan because that is a matter to be resolved by the Bankruptcy Court in the light of this Court's opinions. The third main issue before this Court is the Trustee's request for punitive damages against McClellan Realty.

A. Status of the IIT Mortgages in the Hands of McClellan Realty.

1. Possible Extinction of McClellan's Lien Under U.C.C. Sec.9-504.

McClellan Realty foreclosed on its security interests in certain personalty of Raymond Colliery at a private sale

conducted on February 28, 1978 at which the assets foreclosed upon were sold to Loree Associates for \$50,000. McClellan Realty also foreclosed on the stock of Raymond Colliery at a private sale on October 6, 1978 at which the stock was sold to Joseph Solfanelli as Trustee for the Pagnotti Group for \$1.00. The Creditors argue that these foreclosure sales were unreasonable and that because of such unreasonableness the obligation secured by the mortgages was satisfied.

These foreclosure sales clearly did not comport with the requirements of Sec. 9-504(3) of the Uniform Commercial Code in effect as of the dates of the sales for a number of reasons. 12A Pa.Stat. Sec. 9-504(3)(repealed November 1, 1979).

First, a secured party cannot bid in at its own private foreclosure sale unless the collateral is "of a type cus-

tomarily sold in a recognized market or is of a type which is the subject of widely distributed standard price quotations...." 12A Pa.Stat. Sec.9-504(3) (repealed November 1, 1979). The stock of Raymond Colliery and the other personalty sold by McClellan Realty at the private foreclosure sales do not fit into either of the above categories. See Alliance Discount Corp. vs. Shaw, 195 Pa.Super. 601, 604, 171A.2d 548 (1961).

Second, McClellan Realty notified only Hyman Green, the then sole stockholder of Raymond Colliery, of the private foreclosure sales. Under Sec. 9-504(3) McClellan Realty was obligated to give notice of the sale to the "debtor". Blue Coal and Glen Nan, among others, were guarantors of the IIT obligation secured by the assets of Raymond Colliery and as such were debtors as defined in

Sec. 9-105(d) of the Pennsylvania Uniform Commercial Code. 12A Pa.Stat. Sec. 9-105(d) (repealed November 1, 1979). They were, therefore, entitled to notice of the foreclosure sales and because they were in bankruptcy notice should have been given to the Trustee in Bankruptcy for Blue Coal and Glen Nan. National Acceptance Co. of Am. vs. Medlin, 538 F.Supp. 585, 587 (N.D. 111. 1982); Rush-ton vs. Shea, 423 F.Supp. 468 (D.Del. 1976). No such notice was given. In addition, McClellan Realty has produced no credible evidence that the prices bid for the collateral were commercially reasonable.

When there has been a commercially unreasonable disposition of collateral, the question arises as to the effect of that disposition on the secured party's right to recover the balance of the debt.

The Creditors claim that McClellan Realty's commercially unreasonable disposition of the collateral gives rise to a presumption under Pennsylvania law that the value of the collateral sold equalled the indebtedness secured. The Creditors argue that because McClellan Realty has produced no evidence to rebut this presumption the debt secured by the IIT mortgages has been extinguished. In support of the above argument, the Creditors point to the recent Pennsylvania Supreme Court decision in Savoy vs. Beneficial Consumer Discount Co., ___ Pa. ___, 468 A.2d 465 (1983).

The Creditors' reliance on Savoy is misplaced. The Pennsylvania Supreme Court held in Savoy that a secured party who sold collateral in a commercially unreasonable manner must rebut a presumption that the value of the collateral

sold equalled the indebtedness secured. Failure to rebut this presumption will bar the secured party from obtaining a deficiency judgment against the debtor. The issue in this case is whether the Savoy presumption would extinguish the secured party's rights in other collateral of the debtor in which the secured party has a security interest.

Application of the Savoy presumption to this situation would result in depriving McClellan Realty, as the successor to IIT, of in rem rights against the Raymond Group. Despite our past record of somewhat dubious oracularity, we predict that the Supreme Court of Pennsylvania will not apply the Savoy presumption to extinguish security interests in other collateral of the debtor. See First Pennsylvania Bank, N.A., vs. Lancaster County Tax Claim Bureau, et al., ___ Pa. ___,

_470 A.2d 938 (1983). We will therefore deny the Creditors' request that this Court conclude that the debt secured by the IIT mortgages was extinguished because of McClellan Realty's unreasonable foreclosure sales of Raymond Colliery's assets.

2. McClellan Realty's Claim for Protection of Its Mortgages Against the Creditors.

The Creditors argue that they are entitled under section 359(1) of the Pennsylvania Fraudulent Conveyance Act to set aside the IIT mortgages to the extent necessary to satisfy their claims. Section 359 of the Act provides as follows:

(1) Where a conveyance or obligation is fraudulent as to a creditor, such creditor, when his claim has matured, may, as against any person except a purchaser for fair consideration without knowledge of the fraud at the time of the purchase, or one who has derived title immediately or mediately from such a purchaser:

(a) Have the conveyance set aside or obligation annulled to the extent necessary to satisfy his claim; or

(b) Disregard the conveyance, and attach or levy execution upon the property conveyed.

(2) A purchaser who, without actual fraudulent intent, has given less than a fair consideration for the conveyance or obligation may retain the property or obligation as security for repayment.

39 Pa.Stat. Secs.359(1), (2).

McClellan Realty argues that in the particular complex posture of this litigation it is entitled to a lien position ahead of the Creditors with respect to all or a portion of the IIT mortgages.

McClellan Realty first argues that the Creditors are not entitled to have the IIT mortgages set aside under Sec. 359(1) to the "extent necessary to satisfy [their] claims" but are limited to a recovery equal to the amount of diminu-

tion of the assets of the Raymond Group caused by the November 26, 1973 fraudulent conveyances. *Newman vs. First National Bank of East Rutherford*, 76 F.2d 347, 350 (3d Cir.1935). See *In re MortgageAmerica Corp.*, 714 F.2d 1266, 1272 (5th Cir. 1983); *Damazo vs. Wahby*, 269 Md. 252, 305 A.2d 138, 142 (1973). *McClellan Realty* notes that the Court determined that the IIT mortgages were fraudulent conveyances partly because \$4,085,500 of the IIT loan proceeds were wrongfully funnelled through the Raymond Group to the selling shareholders in payment of the purchase price of Raymond Colliery's stock. *McClellan Realty* claims that a return of \$4,085,500 to the Raymond Group would cure any injury to the Creditors caused by the November 26, 1973 fraudulent conveyances. It further claims that more than \$4,085,500 has



already been returned to the Raymond Group as a result of the \$6,100,000 received by the Creditors and the Commonwealth under the terms of the settlement agreements with the Cleveland and Gillen Defendants.

The payment of the \$6,100,000 has not placed the Creditors in the same or similar position which they held with respect to the Raymond Group prior to the November 26, 1973 fraudulent IIT mortgages transaction. Since November 26, 1973, the Raymond Group paid \$4,589,640 on the fraudulent IIT mortgages. Also since November 26, 1973, the amount owed by the Raymond Group on the mortgages has greatly increased because of the very substantial interest charges provided for in the Note Purchase and Loan Agreement which are claimed by McClellan Realty to be at least \$11,501,850.89. The Creditors

therefore would not be placed in the same or similar position which they held with respect to the Raymond Group in 1973 merely by replacing the \$4,085,500 of IIT loan proceeds that were misused on November 26, 1973.

We also disagree with McClellan Realty's argument that the settlement monies paid to the Creditors and the Commonwealth by the Gillen and Cleveland Defendants should be deducted from the recovery to which the Creditors are entitled from McClellan Realty. The Creditors have claimed in this litigation that the Gillen and Cleveland Defendants are liable for sales of Raymond Group assets made after November 26, 1973 to satisfy the Raymond Group's debt to IIT and others. There is no basis for this Court to apply the \$6,100,000 paid by the Gillens and Clevelands to particular injuries suf-

ferred by the Creditors as the result of the fraudulent conveyances. Moreover, the settlement agreements provided that the monies paid were also in settlement of other lawsuits by the Creditors and the Commonwealth against the Gillens and Clevelands. There is no basis on the present record for a conclusion by this Court that the \$6,100,000 paid by the Gillens and Clevelands pursuant to the settlement agreements was intended solely to compensate the Creditors and the Commonwealth for damages flowing from the Gillens' and Clevelands' acceptance of the IIT loan proceeds on November 26, 1973.

McClellan Realty further argues that the mortgages are entitled to protection under #359(2) of the Act by reason of the payment of \$4,047,786.00 by Pagnotti Enterprises to IIT

for the assignment of the mortgage to McClellan Realty. Section 359(2) of the Pennsylvania Fraudulent Conveyance Act permits a purchaser to retain a fraudulently conveyed property or obligation as security for repayment where such a purchaser (1) is without actual fraudulent intent and (2) has given less than a fair consideration for the conveyance or obligation. 39 Pa.Stat. Sec. 359(2). McClellan Realty does not fit within the literal meaning of the words of the statute.

Section 359(2) has no application to McClellan Realty because although this Court found that Pagnotti Enterprises was without actual fraudulent intent, Glen-eagles II, 571 F.Supp. at 957, we did not find that Pagnotti Enterprises gave "less than a fair consideration" for the IIT mortgages. 39 Pa.Stat. Sec. 359(2).

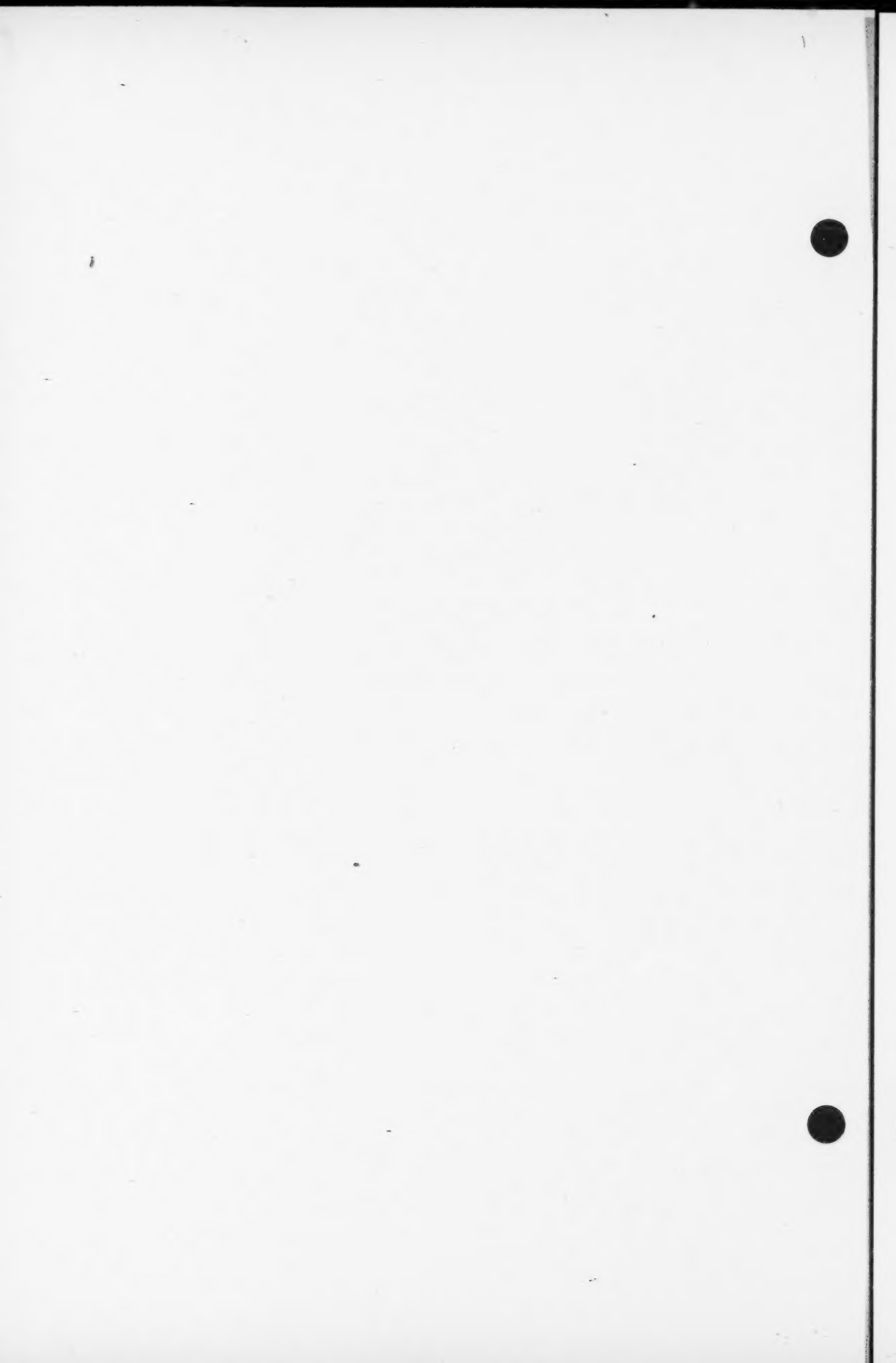
Under the Act, "fair consideration" is defined. Fair consideration is given for a property or obligation "[w]hen, in exchange for such property or obligation, as a fair equivalent therefor and in good faith, property is conveyed...." 39 Pa.Stat. Sec. 353(a). In Gleneagles II this Court concluded that while Pagnotti Enterprises paid a fair equivalent for the IIT mortgages it did not do so in good faith. We concluded that Pagnotti Enterprises either knew or should have known that the November 26, 1973 transaction rendered the Raymond Group insolvent and with insufficient working capital. We also concluded that Pagnotti Enterprises knew or should have known that the IIT mortgages were not supported by fair consideration because of the simultaneous diversion of the \$4,085,500. 571 F. Supp. at 958. While the decision of the Court

in Gleneagles II rested on our determination that Pagnotti Enterprises should have known of the fraudulent nature of the mortgages, we seriously questioned Pagnotti Enterprises' assertion that it did not have actual knowledge of the fraudulent nature of the mortgages. The Court concluded that at least one official of Pagnotti Enterprises knew more about the IIT mortgages transaction than he admitted on the stand. The findings of the Court relating to Pagnotti Enterprises' actual and imputed knowledge of the fraudulent nature of the IIT mortgages prevent any finding that Pagnotti Enterprises purchased the IIT mortgages in good faith. Cohen vs. Southerland, 257 F.2d 737, 742 (2d Cir. 1958); Epstein vs. Goldstein, 107 F.2d 755, 757 (2d Cir. 1939); Gleneagles I 565 F.Supp. at 574.

This Court acts as a court of equity

when determining the relief appropriate under the Pennsylvania Uniform Fraudulent Conveyance Act and in cases such as this one brought under Sec. 7403 of the Internal Revenue Code, 26 U.S.C. Sec. 7403. United States vs. Overman, 424 F.2d 1142, 1#46 (9th Cir. 1970); Greater Valley Terminal Corp. vs. Goodman, 415 Pa. 1, 202 A.2d 89 (1964).

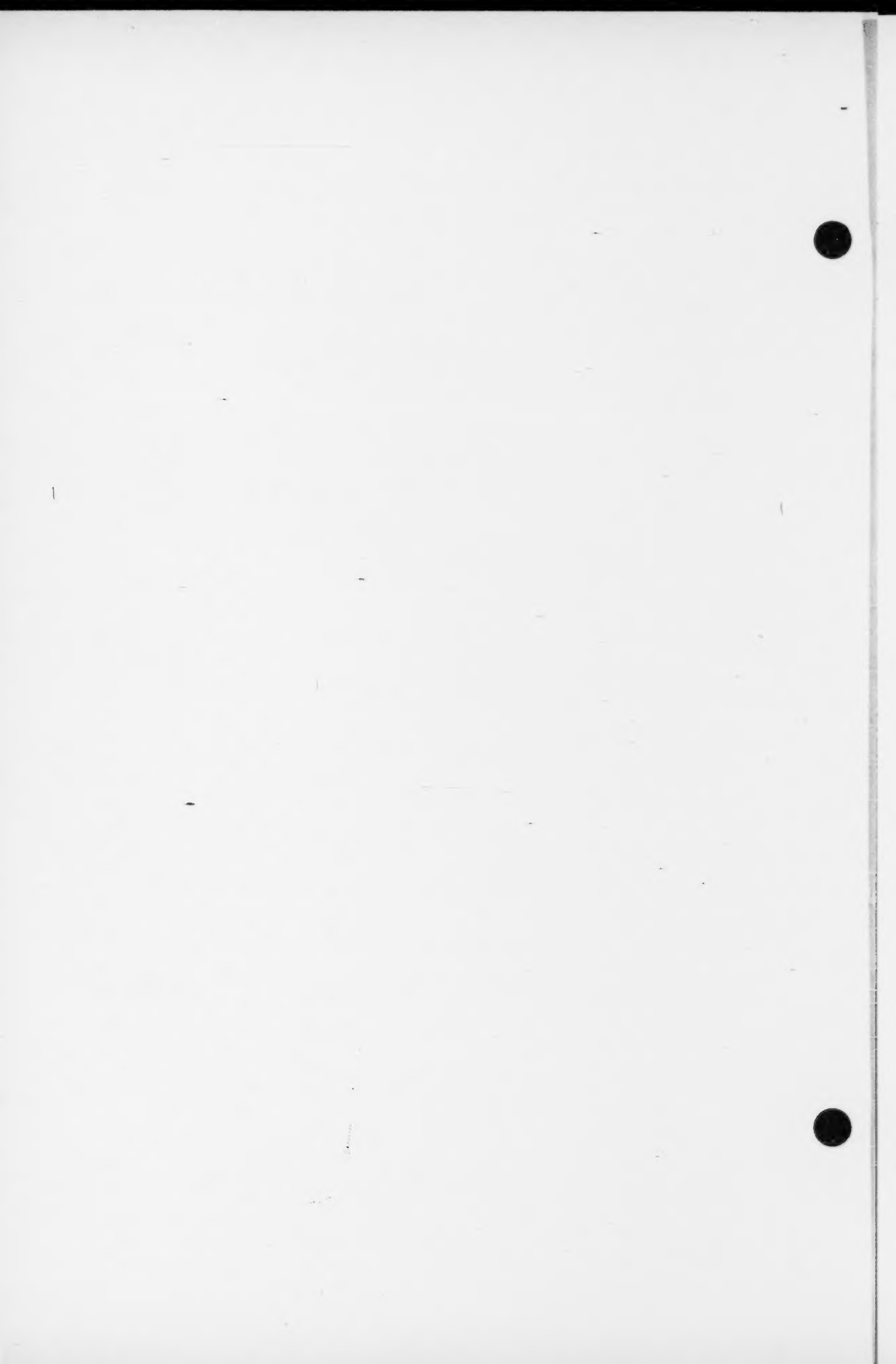
McClellan asks protection of the IIT mortgages to the extent that McClellan Realty paid consideration to IIT. We have examined the case law cited by McClellan Realty and have found no support for the proposition that a purchaser such as McClellan Realty who is not entitled to protection of its position under Sec. 359(1) or (2) may nonetheless be awarded an equitable lien for consideration paid to his transferor. See Peoples Savings & Dime Bank & Trust Co., vs. Scott, 303 Pa.



294, 298, 154 A. 489, 490 (1931).

McClellan Realty also requests proportional protection of its mortgages based upon the extent that the IIT loan proceeds initially benefitted the Raymond Group. McClellan Realty claims this Court found in Gleneagles I. 565 F.Supp. at 570, that \$2,914,500 or 41.64% of the IIT loan proceeds went to the benefit of the Raymond Group and that thus it is entitled to protection of 41.64% of each direct mortgage executed by a member of the Raymond Group.

McClellan Realty's argument rests on the incorrect assumption that some portions of the IIT mortgages are valid as against the Creditors. In Gleneagles I 565 F.Supp. at 580, 586, this Court found that IIT and Durkin engaged in an intentionally fraudulent transaction on November 26, 1973. The IIT mortgages are



therefore invalid in their entirety as to creditors. *Iscovitz vs. Filderman*, 334 Pa. 585, 6 A.2d 270 (1939). *McClellan Realty* asserts that because it was not found to have purchased the IIT mortgages with actual or imputed knowledge that the mortgages were intentionally fraudulent conveyances, the mortgages should be treated as merely constructively fraudulent conveyances in the hands of *McClellan Realty* and that the mortgages should be upheld proportionately to the extent that the proceeds thereof were used to benefit the Raymond Group. See e.g., *Taylor v. Kaufhold*, 379 Pa. 191, 108 A.2d 713 (1954); *Peoples Savings & Dime Bank & Trust Co. v. Scott*, 303 Pa. at 298, 154 A. at 490.

We find no authority for this position. Unless the subtransferee of a fraudulent conveyance purchases in good

faith as set forth in 39 Pa.Stat. Sec. 359(1), it stands in the shoes of its assignor. In *Re Trans-United Industries, Inc.*, 351 F.2d 605 (2d Cir. 1965); *Davis vs. Hudson Trust*, 28 F.2d 740 (3d Cir. 1928); *United States vs. West*, 299 F.Supp. 661 (D. Del. 1969); In *Re Brueck and Wilson Co.*, 285 F. 69 (S.D.N.Y. 1919); *BV Commercial Securities Co.*, 156 S.W. 2d . 338 (1941). McClellan was not a purchaser for fair consideration without knowledge or notice of the fraud for the reasons previously given and holds the mortgages subject to the claims of the Creditors.

In addition, fraudulent liens previously sold are reduced for amounts which have already been paid on the liens. In *Re Peoria Braumeister Co.*, 138 F.2d 520, 523 (7th Cir. 1943). \$4,589,640 was paid on the mortgages by the Raymond Group

before the mortgages were assigned to McClellan Realty. Thus, even assuming that a valid portion of the IIT mortgages originally existed, that portion was extinguished by the payments on the debt in excess of that portion made by the mortgagors before the assignment of the IIT mortgages.

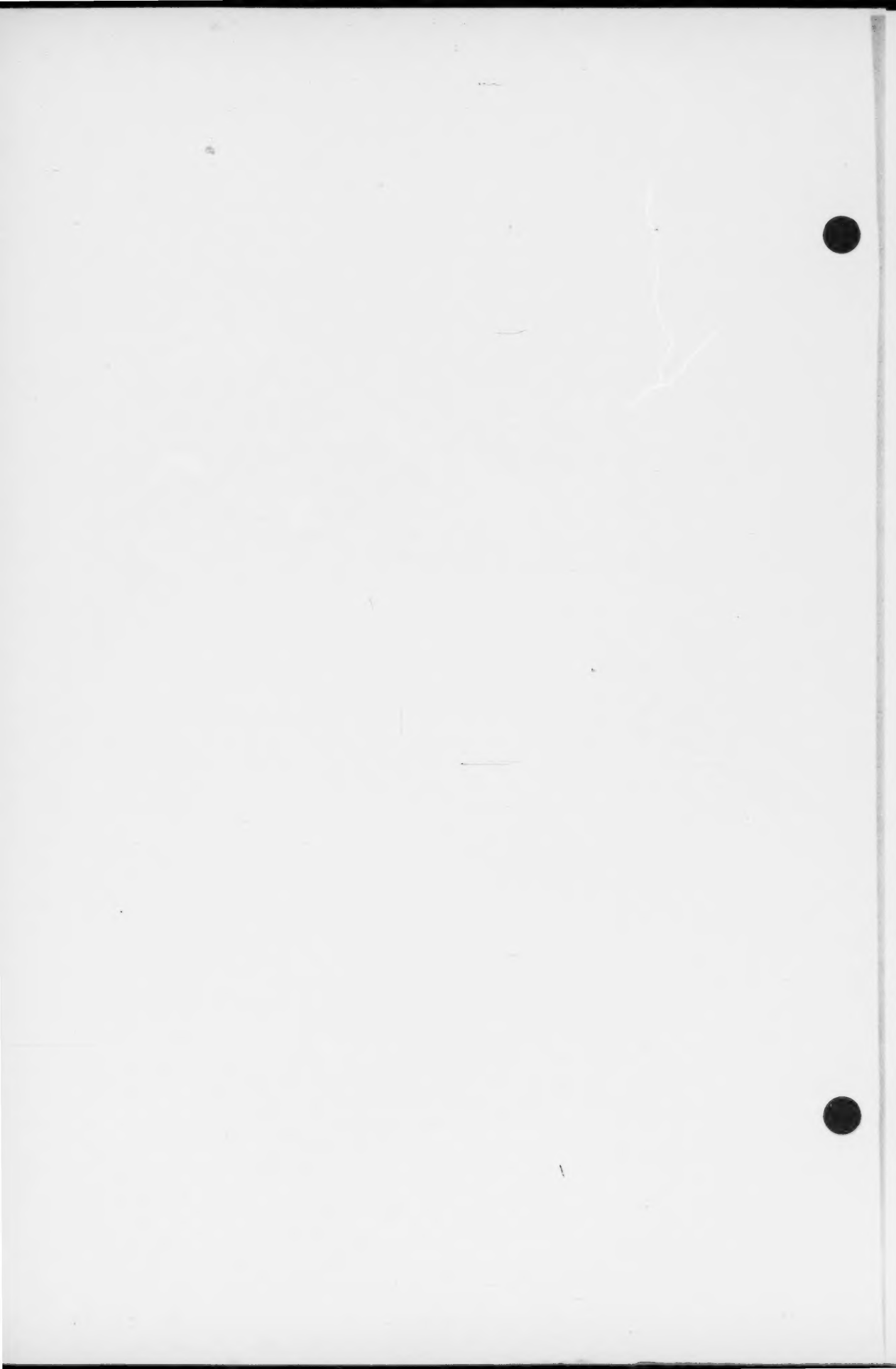
Finally, if there were any need to balance the equities in this case as between McClellan Realty and the Creditors the equities clearly favor the creditors. As this Court noted in Glen-eagles II, we questioned Pagnotti Enterprises' assertion that it did not have actual knowledge of matters which would have caused it to conclude that the IIT mortgages were fraudulent conveyances within the meaning of Secs. 354 and 355 of the Pennsylvania Fraudulent Conveyance Act. We also concluded that Pagnotti

Enterprises was clearly on notice as to numerous facts which if reasonably investigated would have led Pagnotti Enterprises to conclude that the mortgages were fraudulent conveyances. Assuming that Pagnotti Enterprises was aware of the fraudulent nature of the IIT mortgages when it purchased them, it clearly would be inequitable to protect McClellan Realty's position as against the Creditors. Even if Pagnotti Enterprises were merely on notice as to the fraudulent nature of the IIT mortgages, it would likewise be inequitable to favor McClellan Realty's position over that of the Creditors who were not on notice of the fraudulent nature of the mortgages and who could not protect themselves. Unlike the Creditors, Pagnotti Enterprises could have avoided its present predicament if it had exercised ordinary prudence.

Moreover, equity will not act to protect a party who has unclean hands. As discussed in detail in Gleneagles II, Pagnotti Enterprises participated in the November 26, 1973 transaction to some extent. 571 F. Supp. at 955-56. It also acted in bad faith vis a vis the Creditors after its purchase of the LIT mortgages.

Tabor Court Realty is a subsidiary of Loree Associates. McClellan Realty is a subsidiary of Pagnotti Enterprises. Pagnotti Enterprises and Loree Associates are both owned by the Pagnotti, Tedesco, and Ventre families. In the transactions at issue Loree Associates and Pagnotti Enterprises were joint venturers.

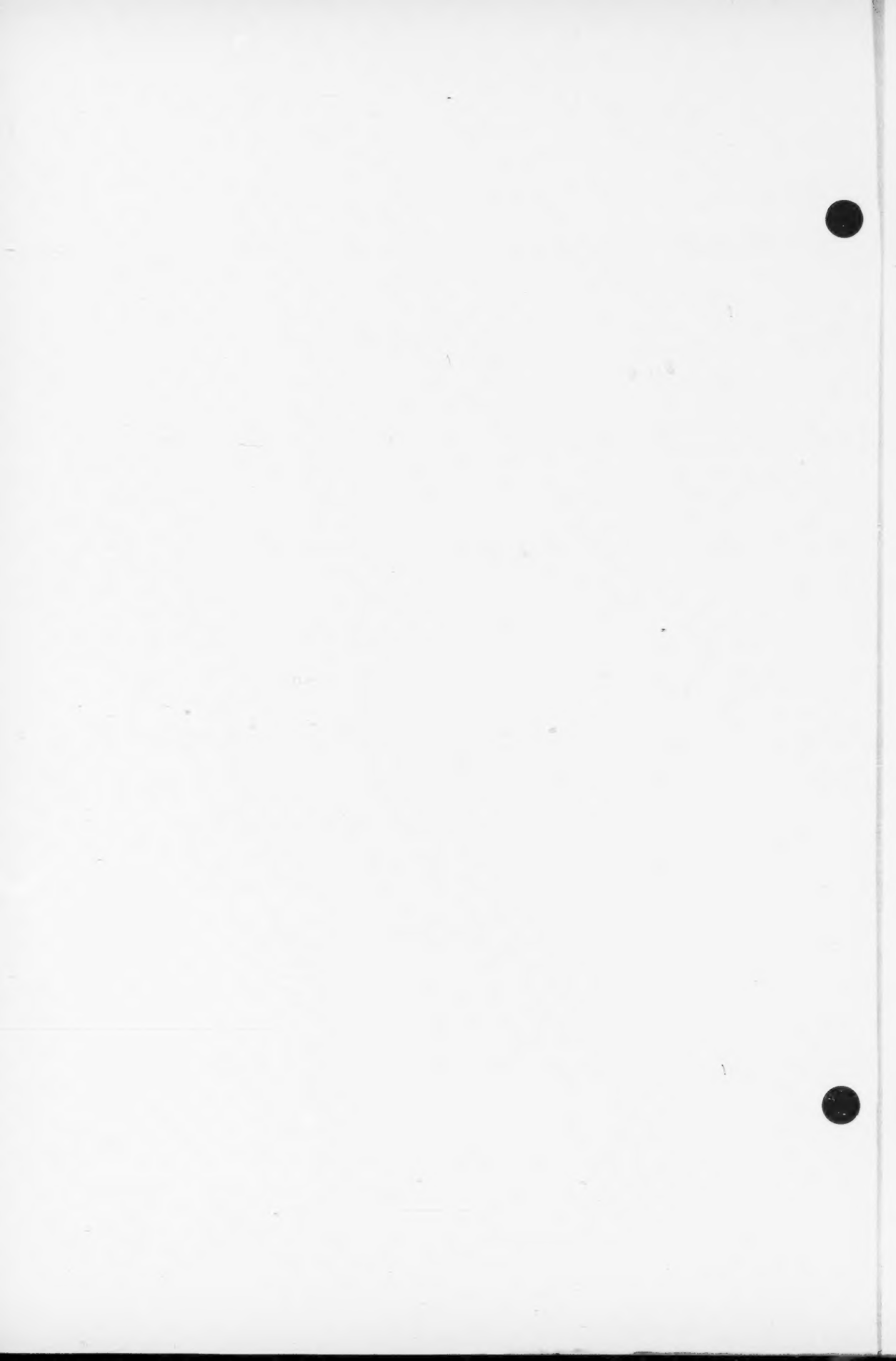
On October 6, 1978, the stock of Raymond Colliery was foreclosed upon by McClellan Realty and sold for \$1.00 to Joseph Solfanelli as Trustee for Pagnotti



Enterprises. Thus, by October 6, 1978, related entities owned the stock of Raymond Colliery, the IIT mortgages, and thought they owned the land of Raymond Colliery although they did not own the land because both of the 1976 and 1980 tax sales were invalid. During this period of common ownership, no monies were paid on the IIT mortgages.

The aggregate balances of the mortgages are claimed by McClellan Realty to have increased by reason of interest accruals from \$5,817.475.69 on January 22, 1977 to \$17,319,326.58 on October 31, 1983. Despite the default on the IIT mortgages, McClellan Realty never foreclosed on the lands of Raymond Colliery.

Also during this period of common ownership, because no real estate taxes were paid on the lands of Raymond Colliery by Tabor Court or any other entity



Lackawanna County again listed the lands of Raymond Colliery for tax sale in 1980. At the 1980 tax sale, Joseph Solfanelli, on behalf of Gleneagles, purchased the Raymond Colliery lands. Mr. Solfanelli was acting on behalf of James Tedesco, a principal of both Loree Associates and Pagnotti Enterprises at the 1980 tax sale.

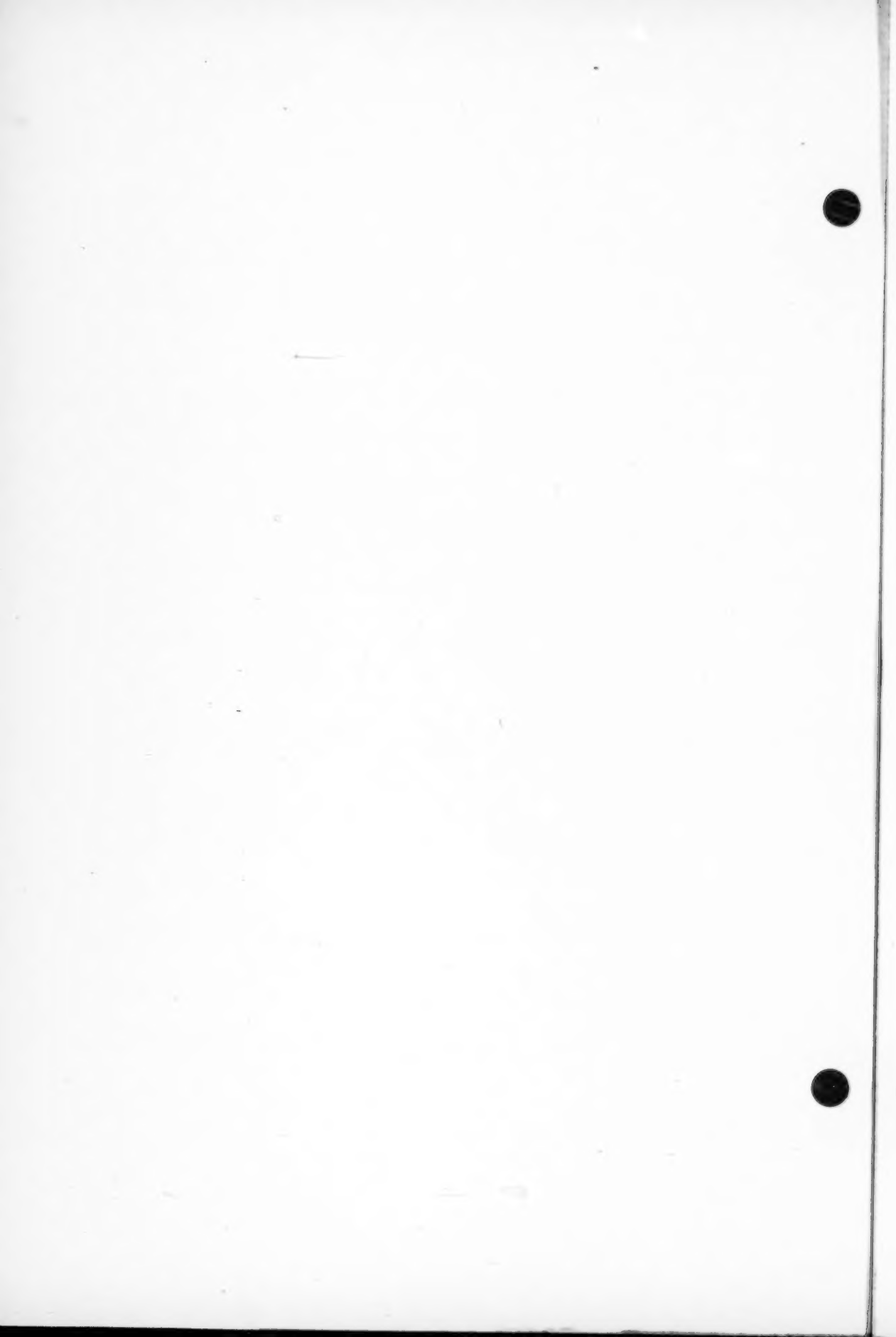
The decision by Pagnotti Enterprises, McClellan Realty, Tabor Court, Loree Associates and Gleneagles (hereinafter collectively called the Pagnotti Defendants) not to pay the real estate taxes on the lands of Raymond Colliery and instead simply to repurchase them at approximately the upset bid price at the 1980 tax sale was part of a scheme to divest the substantial liens on the lands.

The decision not to foreclose on the

IIT mortgages on the lands of Raymond Colliery was also part of a plan to discourage Raymond Colliery's other creditors from seeking to foreclose on their liens. With the exception of certain county and other municipal liens and the Commonwealth liens, the IIT mortgages appeared to be first liens on all the lands of Raymond Colliery. As the IIT mortgages increased in amount, the chances of a junior lienor foreclosing on the lands of Raymond Colliery decreased. In addition, the Pagnotti Defendants may have been attempting to achieve a highly favorable position in the Blue Coal and Glen Nan bankruptcy proceedings. As part of the November 26, 1973 transaction, Blue Coal and Glen Nan executed guarantee mortgages for the entire IIT mortgage debt. Thus, by declining to foreclose on the lands of Raymond Col-

liery and permitting the debt secured by the IIT mortgages to increase, Pagnotti Enterprises could have claimed the bulk of the proceeds from the liquidation of Blue Coal and Glen Nan's assets.

During the trial in this case, James Tedesco testified that the reason McClellan Realty failed to foreclose on the IIT mortgages against the assets of Raymond Colliery was that an attorney for a third party stated to him that if an attempt to foreclose on the mortgages were made, that attorney would file a bankruptcy petition against Raymond Colliery. Assuming that this threat was in fact made we find it extremely difficult to believe that it would have brought about the decision by McClellan Realty not to foreclose on the mortgages. After the 1976 tax sale, Raymond Colliery was purportedly stripped of its most valuable asset,

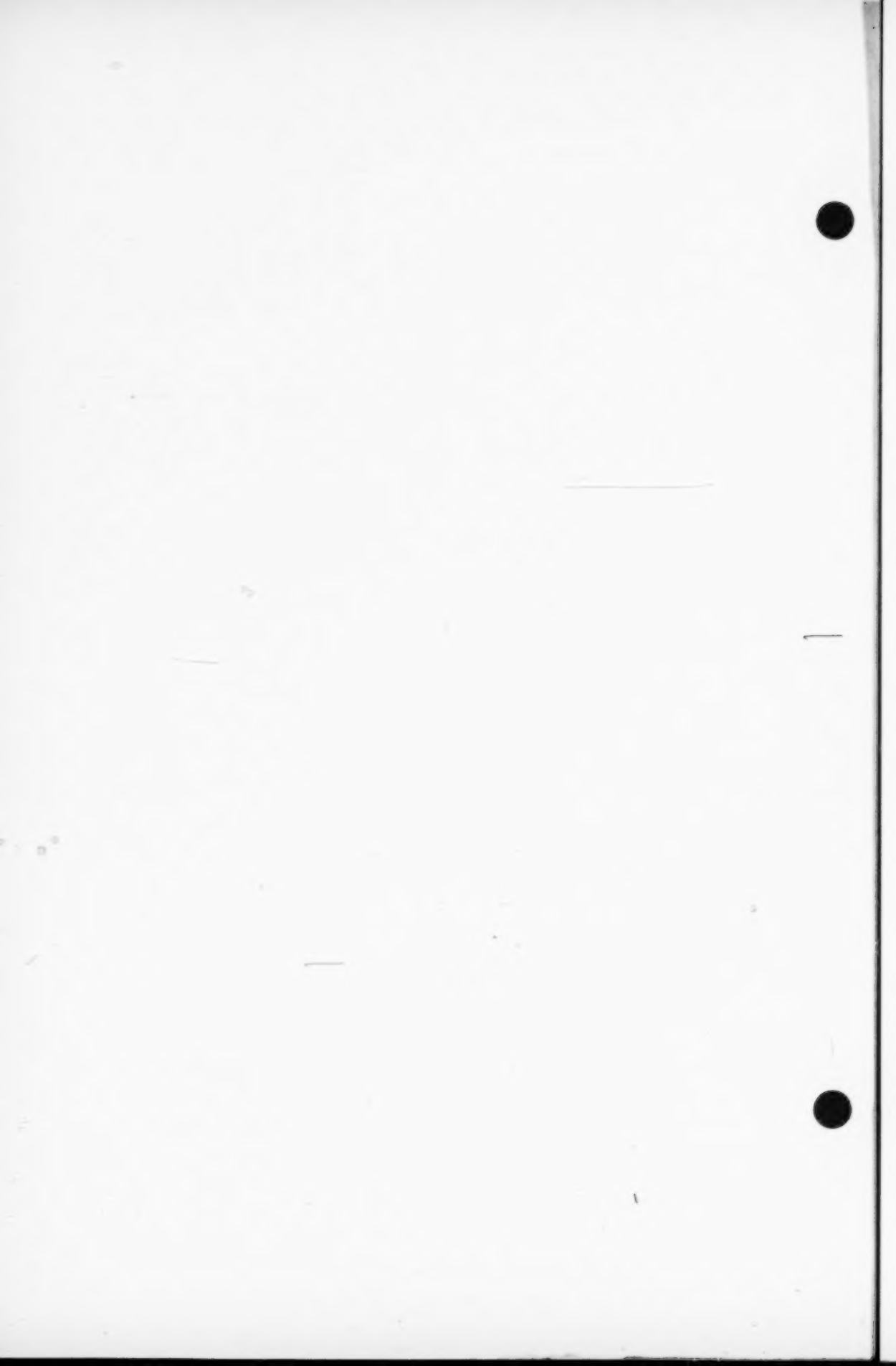


i.e., its land. Hence, the filing against Raymond Colliery of a petition in bankruptcy long after the 1976 tax sale at which the lands of Raymond Colliery were purportedly sold to Tabor Court would have had little or no effect on McClellan Realty's ability to foreclose on its mortgages encumbering the lands.

In short, in light of the behavior of the Pagnotti Defendants after their purchase of the IIT mortgages, McClellan Realty is not entitled to an equitable lien representing any portion of the IIT mortgages.

3. The Pagnotti Defendants' Lien for Taxes Paid on Behalf of Raymond Colliery.

Beginning in 1976, various payments were made by the Pagnotti Defendants on account of Raymond Colliery's delinquent taxes. Some of these payments were made as bids on the lands of Raymond Colliery



at the Lackawanna County tax sales. The prices paid by the Pagnotti Defendants had the effect of paying delinquent realty taxes owed by Raymond Colliery and discharging liens for those taxes from the lands of Raymond Colliery. The Pagnotti Defendants seek first liens on the lands of Raymond Colliery for such payments.

These tax payments are as follows:

A. Payments by L. Robert Lieb.

Payment of Commonwealth Taxes (Finding of Fact 418, <u>supra</u>)	\$ 44,368.74
Payment of pre-1974 Lackawanna County real estate taxes (Gleneagles II, 571 F.Supp. at 947 (Finding of Fact 166))	447,786.13

Payment of pre-1974 City of Scranton Taxes (Finding of Fact 419. <u>supra</u>)	11,122.25
---	-----------

B. Payments by Tabor Court

Bid at 1976 tax sale (Gleneagles II, 571 F.Supp. at 948 (Finding of Fact .190))	\$385,000.00
--	--------------



Less refunds for
overpayments and duplicate
payments in bid
at 1976 tax sale
(Gleneagles II, 571 F.Supp.
at 949 (Findings of Fact 202,
203, 204 and 205)) (38,937.00)

C. Payment by McClellan Realty

Payment of City of Scranton
1974, 1975. and 1976
delinquent real estate taxes
(Finding of Fact 420, supra) 23,179.36

D. Payment by Gleneagles

Bid of Gleneagles at 1980 tax sale
(Finding of Fact 445, 629,225.43
supra)

Raymond Colliery's Commonwealth and
pre-1974 real estate taxes were first
liens on the lands of Raymond Colliery
and were paid by L. Robert Lieb when the
Pagnotti Defendants were neither owners
of the land nor owners of the IIT mortga-
ges. Because of this Court's conclusion
in Gleneagles II that the 1976 tax sale
was invalid, the 1976 Tabor Court bid on
the lands of Raymond#Colliery was tan-



tamount to a payment of Raymond Colliery's real estate taxes and likewise was also a payment made before the Pagnotti Defendants owned the lands of Raymond Colliery or the IIT mortgages. These tax payments discharged liens on the lands of Raymond Colliery which were ahead of those claimed by the United States. Equitably, the Pagnotti Defendants should now receive a lien position reflecting these tax payments ahead of the lien position accorded the United States. Likewise, because the above tax payments by the Pagnotti Defendants discharged liens ahead of the liens claimed in this litigation by the various counties and other municipalities, the Pagnotti Defendants should receive liens reflecting the tax payments ahead of those lienors.

The 1974, 1975, and 1976 taxes due the City of Scranton were not paid by the

Pagnotti Defendants until April, 1977 because the City of Scranton taxing personnel were unable or unwilling to calculate the amounts owed by Raymond Colliery for those years before the 1976 tax sale. However, the Pagnotti Defendants attempted to pay the 1974, 1975, and 1976 City of Scranton taxes as part of Tabor Court's bid at the 1976 tax sale. In our view, the April, 1977 payment to the City of Scranton should be treated in the same manner as the 1976 tax sale bid. The Pagnotti Defendants will therefore also be awarded a lien ahead of the United States and the counties and other municipalities for the 1974, 1975 and 1976 taxes paid to the City of Scranton.

On October 6, 1978 Joseph Solfanelli on behalf of the Pagnotti Defendants bought in the Raymond Colliery stock for \$1.00 and became President of the cor-

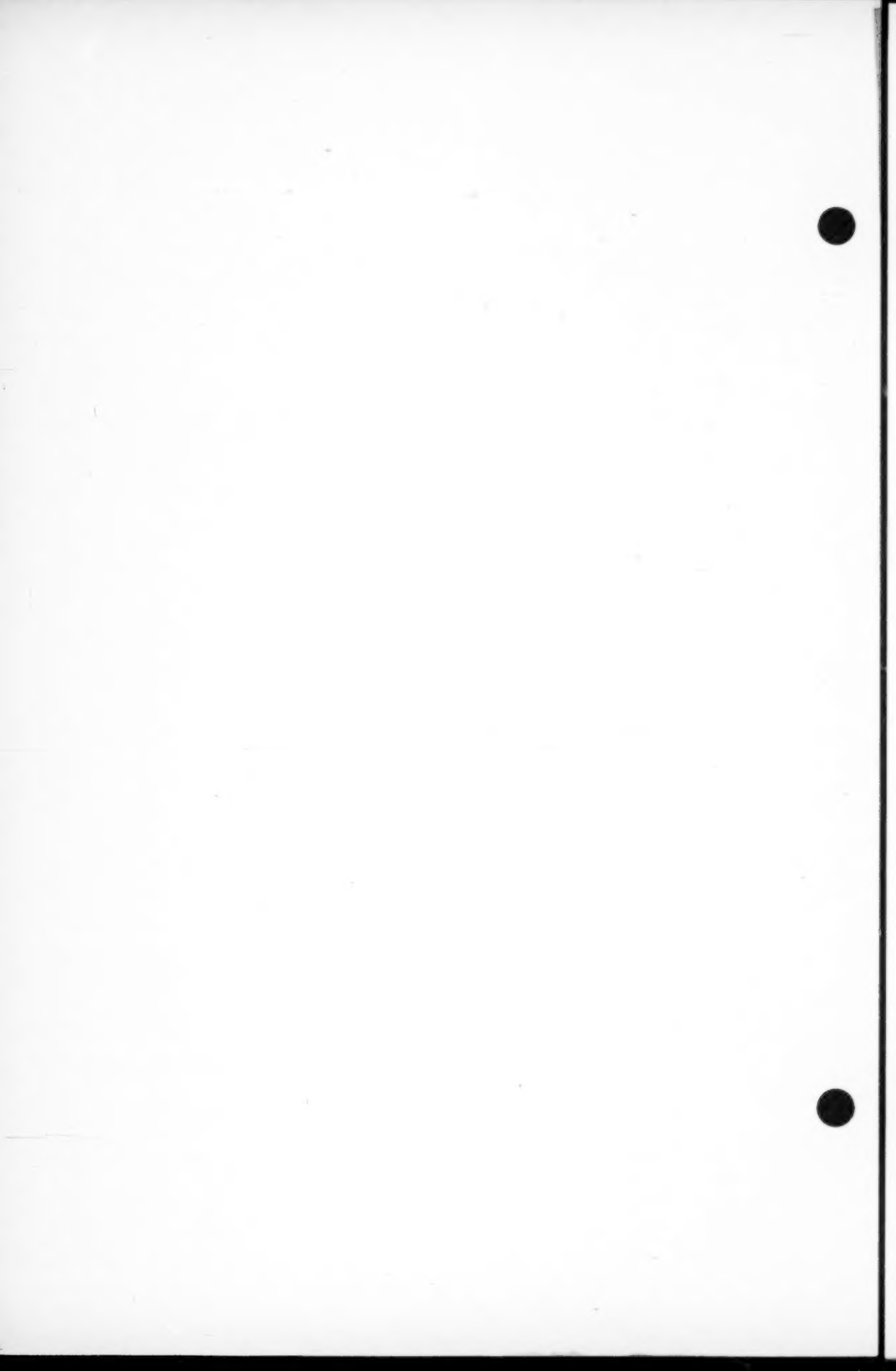


poration. Thereafter, the Pagnotti Defendants as officers, directors, and stockholders of Raymond Colliery, had an obligation to pay current taxes on the lands of the corporation and to treat the creditors of Raymond Colliery fairly. However, they attempted to run the lands through the tax sale in 1980 and purchase the lands through another Pagnotti corporation in order to divest liens of the Creditors, particularly the United States. Balancing the equities we decline to award the Pagnotti Defendants liens ahead of those claimed by the United States and the county and other municipalities for the taxes paid at the 1980 tax sale but will postpone that lien to a position which is immediately ahead of the mortgages themselves.

It is appropriate to make several observations regarding the equitable

liens this Court will award the Pagnotti Defendants. First, it should be noted that McClellan Realty is the Pagnotti Defendant entitled to liens reflecting the December 16, 1976 tax payments by L. Robert Lieb. These payments were made from the escrow account created by IIT and Pagnotti Enterprises prior to the assignment of the IIT mortgages to McClellan Realty. Pagnotti Enterprises reimbursed IIT for its contribution to the escrow account and the December 16, 1976 payments were added to the balance of the IIT mortgages assigned to McClellan Realty.

Second, the December 16, 1976 tax payments by L. Robert Lieb and the April 1977 payment to the City of Scranton by McClellan Realty for delinquent 1974, 1975, and 1976 real estate taxes were added to the balance of the IIT Mortgag-



es. However, because the mortgages were fraudulent as to creditors, we decline to award equitable liens reflecting these payments with interest at the rate provided for in the LIT mortgages and as blanket liens on the assets of Raymond Colliery. Recovery of these payments at the statutory interest rate and from the proceeds of the sales of the particular parcels against which the taxes were liens is fair to McClellan Realty.

Third, all of the above tax payments by the Pagnotti Defendants are listed in aggregate amounts. With the exception of the December 16, 1976 payment for Commonwealth taxes, the Pagnotti Defendants must still produce evidence as to all tax payments proving to which parcels the tax payments related and the amounts of the liens on each such parcel. Because Commonwealth taxes were liens on all parcels

of Raymond Colliery property, 72 Pa. Stat. Sec. 1401, the equitable lien accorded McClellan Realty for payment of those taxes will be an equitable lien against all parcels of Raymond Colliery land generally.

B. The Order of Liens on the Lands of Raymond Colliery.

The jurisdiction of this Court was invoked under 26 U.S.C. Sec. 7403 which permits the United States to bring a civil action in federal court to enforce federal tax liens. Section 7403(c) provides as follows:

The court shall...proceed to adjudicate all matters involved therein and finally determine the merits of all claims to and liens upon the property, and, in all cases where a claim or interest of the United States therein is established, may decree a sale of such property, by the proper officer of the court, and a distribution of the proceeds of such sale according to the findings of the court in respect to the interests of the parties and of the United States

.....

26 U.S.C. Sec. 7403(c).

The following entities possess liens against the lands of Raymond Colliery: the United States, the Commonwealth of Pennsylvania, McClellan Realty, Lackawanna County, the Borough of Olyphant, the Scranton Sewer Authority, the Lackawanna River Basin Sewer Authority, the Borough of Taylor, and the Estate of William R. Henkelman. The principal amounts of the liens claimed by the above entities to the extent the Court was able to ascertain such amounts are set forth in the Findings of Fact.

Federal law determines the priority of a federal tax lien. *Aquilino vs. United States*, 363 U.S. 509 (1960). Except as provided in 26 U.S.C. Sec. 6323, the federal rule of priority is first in time, first in right. *United*

States vs. City of New Britain, 347 U.S. 81 (1954). A federal tax lien arises as of the date the tax is assessed. 26 U.S.C. Sec. 6323(b)(6) provides that "super-priorities" are to be given to certain county and other municipal tax liens notwithstanding that such liens may have arisen after the federal tax lien. Thus, under federal law the county and other municipal liens encumbering the lands of Raymond Colliery are entitled to priority over the federal tax liens.

State law determines the priority of liens among non-federal lienors. Pennsylvania law provides that the Commonwealth's tax liens are a first lien on all of its taxpayers' real and personal property. 72 Pa.Stat. Sec. 1401. Delinquent county real estate taxes and municipal claims, including sewer, paving and demolition liens, follow Commonwealth

liens in that order.

There is, therefore, a conflict between the rules of priority established by federal and state law with respect to the lien positions to be accorded the liens of the Commonwealth, the county and the other municipalities giving rise to a so-called "circular priority" problem. When circular priority problems surface, federal law and the first in time, first in right rule determine the position of the federal tax liens and state law determines the priorities around the federal tax liens. Because Pennsylvania law provides a priority for Commonwealth taxes superior to that provided to county and other municipal claims, the Commonwealth may take advantage of the federal "super-priorities" accorded county and other municipal liens in 26 U.S.C. Sec. 6323. This entitles the Commonwealth to

priority over federal tax liens as provided by 26 U.S.C. Sec. 6323 in the amount of the appropriate municipal liens. The county and other municipal liens then receive a position following the lien positions accorded the claims of the United States and the Commonwealth.

The following chart indicates the order of priority of liens on the lands of Raymond Colliery. Those lienors marked with an asterisk hold liens as described at the right of the asterisk encumbering particular parcels of Raymond Colliery land. The lienors not marked with an asterisk hold liens as described at the right of the asterisk on all of the lands of Raymond Colliery.

<u>Lienor</u>	<u>Description</u>
1. McClellan Realty	Payment of Commonwealth taxes by L. Robert Lieb. (Finding of Fact 418,

supra.)

2. McClellan Realty*

Scranton taxes by

Payment of Lackawanna County and City of

L. Robert Lieb
(Gleneagles II,
Finding of Fact
166 and Finding
of Fact 419,
supra.)

3. Tabor Court*

Upset bid paid at
1976 Lackawanna
County tax sale
minus refunds.
(Gleneagles II,
Findings of Fact
190, 202 and
203.)

4. McClellan Realty*

Payment to City
of Scranton of
delinquent 1974,
1975 and 1976
real estate
taxes. (Finding
of Fact 420,
supra.)

5. Commonwealth*

Municipal and
county lien
positions assumed
by the Common-
wealth pursuant
to 26 U.S.C. Sec.
6323(b).

6. United States

Federal taxes
assessed 9/17/73.



(Findings of Fact
456 and 457,
supra.)

7. Commonwealth

Commonwealth tax
liens filed be-
tween 4/13/76 and
1/27/77.
(Findings of Fact
448, supra.)

8. United States

Federal taxes
assessed between
4 / 3 / 7 9 and
4/22/81. (Findings
of Fact 455, 459,
supra.)

9. Commonwealth

Tax liens filed
6/11/82 and
7/12/83 (Findings
of Fact 447 and
449, supra.).

NOTE: These
liens will be
reduced at the
time of distribu-
tion for amounts
recovered by the
Commonwealth pur-
suant to its
priority position
under 26 U.S.C.
Sec. 6323(b).

10. Lackawanna County*

County, school
and borough taxes
for 1981 and
1982. (See Finding
of Fact 465,



- supra.)
11. Scranton Sewer Authority* Sewer liens as
sessed between
9 / 27 / 69 and
12/29/72. (Find-
ings of Fact 467
and 468, supra.)
12. Borough of
Olyphant* Paving liens
encumbering 4
parcels of Ray-
mond Colliery
land. (See Find-
ing of Fact
471, supra.)
13. Lackawanna River
Basin Sewer Auth-
ority* Sewer liens as-
sessed.
(Finding of
Fact 473, supra.)
14. Borough of Taylor* Demolition lien
encumbering one
parcel of Raymond
Colliery's land
filed December
15, 1976. (Find-
ing of Fact 476,
supra.)
15. Gleneagles* Tax payments made
in connection
with the 1980
Lackawanna County
Tax sale (Find-
ings of Fact 445,
supra.)
16. McClellan Realty 11T Mortgage (See
Finding of Fact

17. Estate of William Arbitrators award
R. Henkelman (Finding of Fact
478, supra.)

This Court was unable to ascertain the principal amounts of certain liens including the "super-priority" liens of the Commonwealth, the Scranton Sewer Authority liens and the 11T mortgages. The Court could not calculate the amount of the super-priority liens of the Commonwealth because it could not determine the principal amount .of the liens claimed by the Scranton Sewer Authority. This is based on the fact that no documentation was filed with respect to the Scranton Sewer Authority lien claimed against the tract at 326-328 Charles Street, Scranton. Furthermore, the Court could not determine with accuracy the Scranton Sewer Authority's original assessments, the amounts paid thereon, and

the interest calculations. Lastly, the computation by the Scranton Sewer Authority of the aggregate amount of its liens contained an arithmetical reversal and is incorrect.

The Court could not ascertain the principal amount owing on the IIT mortgage against the lands of Raymond Colliery because although we have the interest charged on the IIT mortgages from January 26, 1977, the date McClellan acquired the mortgages, we are unable to ascertain with assurance the principal amount owed on the Mortgage as of that date. Finally, the Borough of Olyphant has not provided evidence as to which parcels of Raymond Colliery lands its liens encumber. Hence, no final order respecting the amounts of liens on the lands of Raymond Colliery can be entered at this time. The Court will order the parties to at-

tempt in good faith to agree upon a form of decree consonant with this opinion listing the priority of liens, the original principal amount of each lien, the date the principal accrued, the date the lien attached, the dates and amounts of any principal payments any applicable penalties, the interest rate applicable to the lien if other than 6%, the total interest to April 30, 1984, any record costs relating to the liens, the tract or tracts encumbered if less than all of the lands of Raymond Colliery, and the combined principal and interest owned on each lienor's claim as of April 30, 1984 in gross, if all the lands are subject to the liens, or particularized as to tract or tracts encumbered if less than all of the lands of Raymond Colliery are so encumbered.

The Commonwealth has suggested that

in the event insufficient proceeds are realized from the sale of Raymond Colliery's land this Court should apply the doctrine of marshalling of assets to the satisfaction by the creditors of their liens. The doctrine of marshalling of assets requires that where one creditor has two funds or sources from which to seek payment and another creditor has only one, the creditor with two sources must first proceed against the source which the other creditor cannot reach. Sowell vs. Federal Reserve Bank, 268 U.S.449, 456 (1925). Certain of Raymond Colliery's creditors, in particular the United States, have two or more funds from which they can satisfy their liens. In our view, it is premature to reach the question of whether the doctrine of marshalling should be applied in this case.

C. Punitive Damages.

The Trustee in Bankruptcy seeks punitive damages against McClellan Realty in his cross-claim and argues that McClellan Realty should be assessed punitive damages for its failure to investigate the use made of the IIT loan proceeds.

Under Pennsylvania law punitive damages may not be awarded against a party unless that party has been found liable for actual damages. Hilbert vs. Roth, 35 Pa. 270, 276 (1959). Because no compensatory damages have been claimed or will be assessed against McClellan Realty, the Trustee's claim for punitive damages against McClellan Realty is without merit. In addition, McClellan Realty's conduct in this case has not been shown to be sufficiently wanton, reckless or outrageous so as to justify an award of punitive damages.

IV. Conclusions of Law.



1-13. The conclusions of law in Glen-eagles I are incorporated herein by reference.

14-17. The conclusions of law in Gleneagles II are incorporated herein by reference.

18. Officers and agents of the Pagnotti Defendants who were also agents and controlling stockholders of Raymond Colliery breached their duty to the creditors of Raymond Colliery to act in good faith with respect to such creditors in connection with the Lackawanna County 1980 tax sale.

19. The United States is entitled to have the IIT direct mortgage on the lands of Raymond Colliery set aside to the extent of the claims of the United States.

20. The Trustee is entitled to have the IIT direct mortgages on the lands of



Blue Coal and Glen Nan set aside to the extent of the Trustee's claims.

21. The tax liens held by the Commonwealth of Pennsylvania reflecting unpaid corporate taxes owed by Raymond Colliery for fiscal years ending June 30, 1969 through June 30, 1980 are entitled to priority on the lands of Raymond Colliery over the IIT mortgages.

22. McClellan Realty is entitled to a lien in the principal amount of \$44,368.74 against the lands of Raymond Colliery with respect to which Commonwealth taxes were paid by L. Robert Lieb on December 16, 1976.

23. McClellan Realty is entitled to liens in the aggregate principal amount of \$458,908.38 on the parcels of Raymond Colliery's land with respect to which pre-1974 Lackawanna County real estate taxes were paid by L. Robert Lieb on

December 16, 1976.

24. Tabor Court is entitled to liens in the aggregate principal amount of \$346,063.00 on the parcels of Raymond with respect to which Lackawanna County real estate taxes were paid by virtue of Tabor Court's 1976 bid on the landsof Raymond Colliery.

25. McClellan Realty is entitled to liens in the aggregate principal amount of \$23,179.36 on the parcels with respect to which City of Scranton 1974, 1975 and 1976 real estate taxes were paid.

26. The United States is entitled to liens on the lands of Raymond Colliery reflecting unpaid federal income taxes assessed against Raymond Colliery and its subsidiaries for fiscal years ending June 30, 1966 through June 30, 1969 and June 30, 1971 through June 30, 1973.

27. The United States is entitled to

a lien on the lands of Raymond Colliery reflecting unpaid federal income taxes assessed against Great American and its subsidiaries for fiscal year ending June 30, 1975.

28. The Commonwealth of Pennsylvania is entitled to liens on the lands of Raymond Colliery reflecting unpaid corporate taxes assessed against Raymond Colliery for fiscal years ending June 30, 1969 through June 30, 1972 and June 30, 1974 through June 30, 1980.

29. Lackawanna County is entitled to liens on 129 parcels of Raymond Colliery's land reflecting unpaid county, school and borough taxes due from Raymond Colliery for 1981 and 1982.

30. The Scranton Sewer Authority is entitled to liens on 35 parcels of Raymond Colliery's lands reflecting unpaid sewer assessments made between September

27, 1969 and December 29, 1972.

31. The Borough of Olyphant is entitled to liens on 4 parcels of Raymond Colliery's land reflecting unpaid paving assessments.

32. The Lackawanna River Basin Sewer Authority is entitled to liens on 65 parcels of Raymond Colliery's lands reflecting unpaid sewer assessments made on unspecified dates against Raymond Colliery and Tabor Court.

33. The Borough of Taylor is entitled to a demolition lien on one parcel of Raymond Colliery's land preantepenultimate in position and immediately prior to the Gleneagles' lien for tax payments made in connection with the 1980 tax sale.

34. Gleneagles Investment is entitled to liens in the aggregate principal amount of \$629,225.43 on the par-

cels with respect to which Lackawanna County real estate taxes were paid by virtue of Gleneagles bid at the 1980 tax sale.

35. McClellan Realty is entitled to a lien against the lands of Raymond Colliery for the principal and interest due on the 11T direct mortgage executed on November 26, 1973 by Raymond Colliery.

36. The Estate of William R. Henkelman is entitled to a lien against the lands of Raymond Colliery reflecting the unpaid arbitrator's award entered against Raymond Colliery on August 30, 1977.

37. The foreclosure sales by McClellan Realty of Raymond Colliery's stock and other assets held on February 28, 1978 and October 6, 1978 were commercially unreasonable.

An appropriate order will be entered.

DATED: April 10, 1983 MUIR, U.S. District J.

UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF PENNSYLVANIA

UNITED STATES OF :
AMERICA, :
 :
Plaintiff : Civil No. 80-1424
 :
vs. : (Reassigned to
 : Judge Muir
GLENEAGLES INVESTMENT: 3/5/81)
CO., INC., et al., :
 :
Defendants :

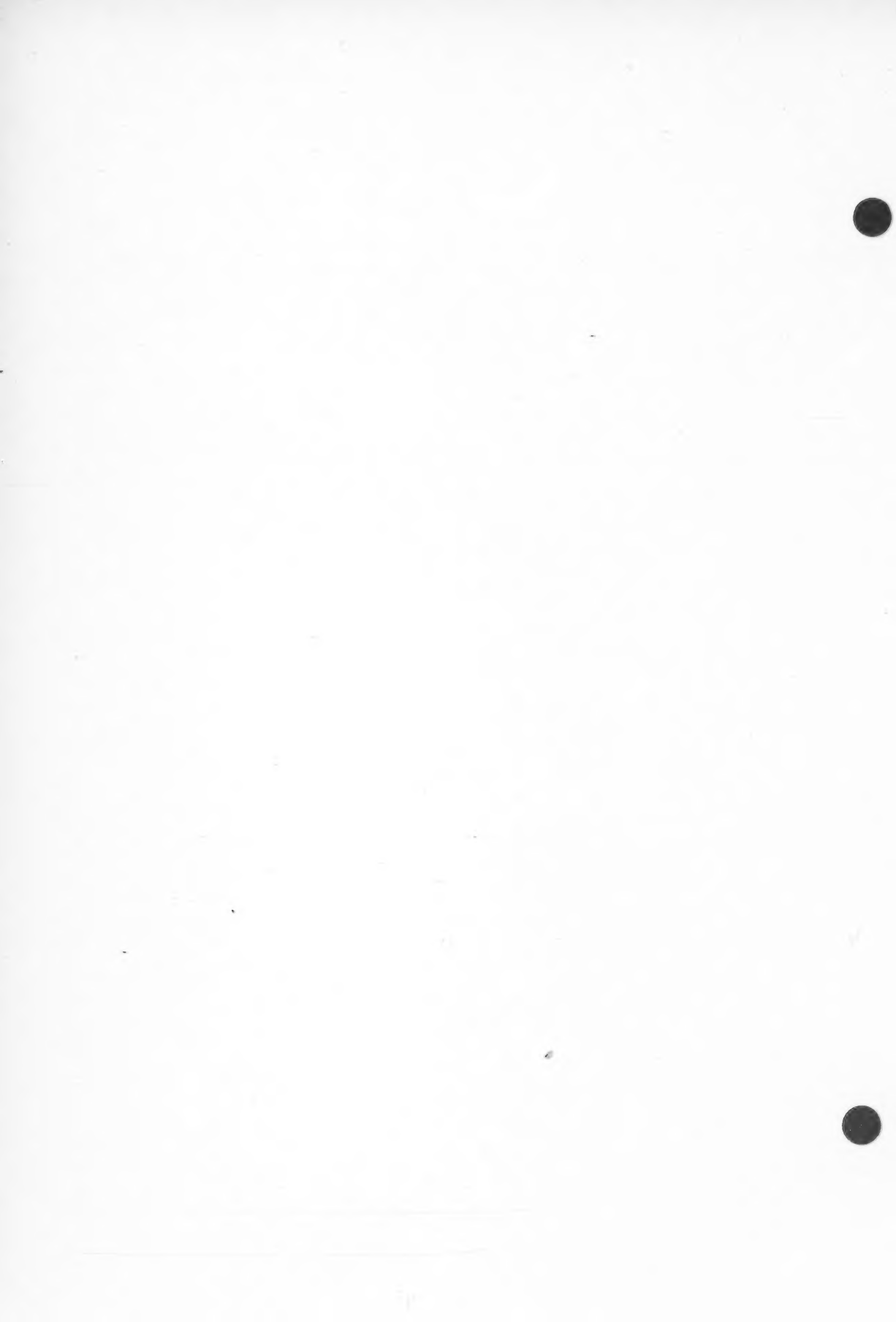
ORDER

1. Counsel for the parties shall meet and attempt in good faith to agree upon a form of decree consonant with this opinion and file the same within 60 days listing by columnar schedule or schedules and in this columnar order the following:

Column

(1) The priority of liens referencing the lien category number shown on pages 38 through 40.

(2) The original principal amount of



each lien.

(3) The date on which the original principal amount of each lien accrued.

(4) The date the lien attached.

(5) The dates and amounts of any principal payments.

(6) The applicable penalties.

(7) The interest rate applicable to the lien if other than 6%.

(8) The dates and amounts of any interest payments.

(9) The total interest on the principal to April 30, 1984 with respect to each lien.

(10) Any record costs relating to the liens.

(11) The tract or tracts encumbered by each particular lien, if the lien encumbers less than all of the lands of Raymond Colliery.

(12) The combined principal and



11

12



interest owed on each lien claimed as of April 30, 1984 as to each lien in gross if all lands are subject to the liens or particularized as to tract or tracts encumbered if less than all of the lands of Raymond Colliery are so encumbered.

2. If the parties are unable timely to agree upon a form of decree as specified in paragraph 1, those parties who can agree upon the form of a decree shall submit a joint proposed decree to the Court within 60 days and each party unable to agree with any other party upon the form of decree shall submit his or its own proposed decree within the same period.

3. If the parties are unable timely to agree upon a form of decree as specified in paragraph 1, each party shall file his objections to the form of decree or decrees proposed by all other parties

and a brief in support thereof within 75 days after the date of this order. Responsive briefs shall be filed within 90 days after the date of this order by all parties to whose proposed form of decree objections have been filed. Reply briefs shall be filed within 100 days after the date of this order.

4. If the parties are unable timely to agree upon a form of decree as specified in paragraph 1, the parties shall submit to the Court a statement within 75 days after the date of this order of any factual issues remaining to be tried with respect to the priority and amount of liens. Any such issues will be set by the Court promptly thereafter for trial.

5. If there are any arithmetical or typographical errors in the opinion bearing even date herewith, counsel shall move for correction thereof within 30

days after the date of this order.

 /s/
MUIR, U.S. District Judge

DATED: April 10, 1984

UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF PENNSYLVANIA

UNITED STATES OF :
AMERICA, :
 :
Plaintiff : Civil No. 80-1424
 :
vs. : (Reassigned to
 : Judge Muir
GLENEAGLES INVESTMENT: 3/5/81)
CO., INC., et al., :
 :
Defendants :

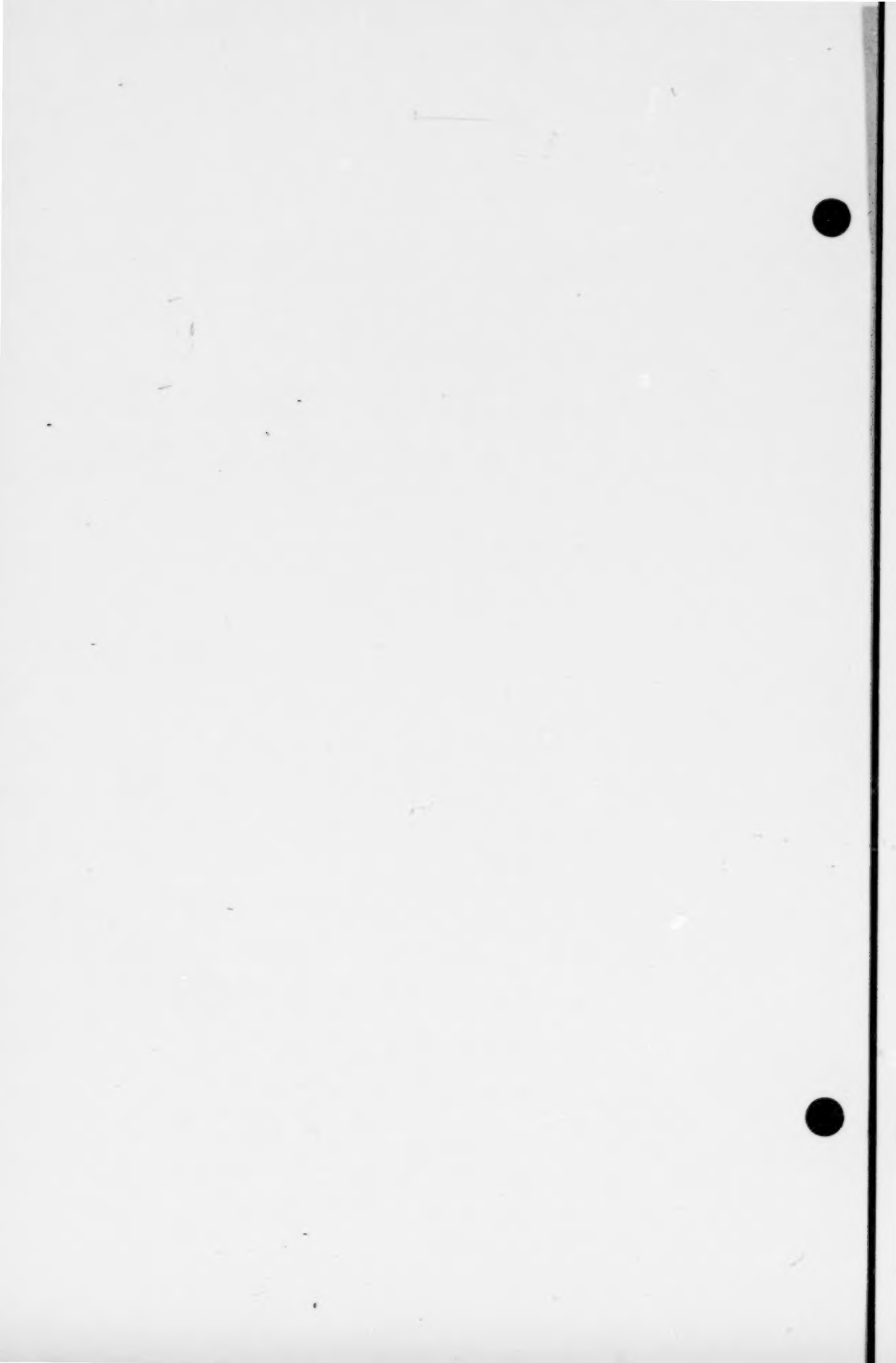
FINAL ORDER AND JUDGMENT
March 26, 1985

THE BACKGROUND OF THIS ORDER IS AS
FOLLOWS:

This action came on for trial to the Court upon the Complaint of the United States seeking to reduce to judgment certain federal tax claims, to foreclose federal tax liens against the taxpayers' real properties, to void as fraudulent and illegal transfers of the real properties purportedly made consequent to county tax sales, to set aside as fraudulent conveyances or to extinguish certain

Exhibit "D"

mortgages and liens of McClellan Realty Corporation, and to determine the existence and order of priority of all liens on such properties sought to be sold in satisfaction of the tax claims of the United States. Also adjudicated was the cross claim of the Trustee in Bankruptcy of Blue Coal Corporation and Glen Nan, Inc., wherein he sought, inter alia, the avoidance of certain mortgages on the lands of Blue Coal and Glen Nan, Inc. as fraudulent conveyances. This order is based upon the evidence presented to the Court, this Court's judgments previously awarded herein, including the partial summary judgment entered on September 17, 1982 in favor of the United States against Raymond Colliery, Inc. and its subsidiaries for delinquent taxes and statutory additions due and owing for the fiscal years ended June 30, 1972 and June



30, 1973, and the default judgment entered on February 2, 1982 in favor of the United States against Great American Coal Company for delinquent taxes and statutory additions in the amount of \$3,780,525.09, plus statutory additions, and this Court's Findings of Fact and Conclusions of Law entered on May 20, 1983, September 13, 1983, and April 10, 1984. We have considered the objections of the Pagnotti Defendants to the proposed final order submitted by the parties and find them to be without merit.

NOW, THEREFORE, IT IS ORDERED THAT:

1. Judgment be, and it hereby is, awarded in favor of the United States against the former subsidiaries of Great American Coal Company, including Raymond Colliery Company, Inc., Blue Coal Corporation and Glen Nan, Inc., in the amount of \$4,964,054.74 plus statutory

additions after April 30, 1984, on account of unpaid corporate income taxes, penalties and interest due and owing by Great American Coal Company and its subsidiaries for the fiscal year ending June 30, 1975, provided, however, that the foregoing shall not be deemed to vitiate the statutory restrictions prohibiting, under certain circumstances, the payment of post-petition interest and penalties in bankruptcy proceedings involving Blue Coal Corporation and Glen Nan, Inc.

2. Judgment be, and it hereby is, awarded in favor of the Commonwealth of Pennsylvania against Raymond Colliery Company, Inc. for past due corporate taxes for the years and in the amounts set forth on pages 69 and 71 of Schedule A attached hereto.

3. The United States of America has valid and subsisting tax liens as of the

dates of assessment, notice and demand, as set forth in Schedule A attached hereto in the amount of \$8,652,392.59 set forth therein, plus statutory additions after April 30, 1984 and Plaintiff's tax liens attach to all property belonging to Raymond Colliery Company, Inc., and its subsidiaries (excluding Blue Coal Corporation and Glen Nan, Inc.) and to all property belonging to Great American Coal Co.

4. With respect to the property of Raymond Colliery Company, Inc. set forth in Schedule A attached hereto, McClellan Realty Co., Tabor Court Realty Co., the United States of America, the Commonwealth of Pennsylvania, the County of Lackawanna, the City of Scranton, the Lackawanna River Basin Sewer Authority, the Scranton Sewer Authority, the Boroughs of Olyphant and Taylor, Gleneagles

Investment Co., Inc. and the Estate of William R. Henkelman all have valid and subsisting liens to the extent and with respect to the property of Raymond Colliery Company, Inc. set forth in Schedule A attached hereto and in the order of priority set forth in Schedule A. Schedule A lists the above liens according to their relative order of priority, lists the specific property to which the liens attach and lists other pertinent information in accordance with this Court's order herein of April 10, 1984.

5. The two Lackawanna County tax sales of the real estate (including land purportedly owned by Tabor Court Realty) of the Raymond Group which is comprised of Raymond Colliery, Inc. and subsidiaries and the deeds issued consequent thereto, complained of by the Plaintiff, which sales purportedly took place on

December 17, 1976 and December 16, 1980, are, and at all times were, void and of no effect, and conveyed no interest in Raymond Group or Tabor Court Realty real properties and displaced no liens thereon because such alleged tax sales were wholly defective insofar as the Lackawanna County Tax Claim Bureau did not comply with the posting requirements set forth (in) 72 Purdon's Statutes Section 5860.-602 as heretofore stipulated by the parties (see Stipulation filed June 15, 1983) and for the reasons determined by this Court in its above-referenced Findings of Fact and Conclusions of Law.

6. The mortgages and security instruments executed by Raymond Colliery Company, Inc., its parent and subsidiaries to Institutional Investors Trust (hereinafter "IIT") and assigned to Defendant McClellan Realty Corporation and

all alleged liens purporting to secure the liabilities secured by such mortgages and instruments, including any judgment liens, are set aside as against those creditors of Raymond Colliery Company, Inc., its parent and subsidiaries, as set forth in Schedule A attached hereto, as fraudulent conveyances.

7. The mortgages and security instruments executed by Raymond Colliery Company, Inc., its parent and subsidiaries to IIT and assigned to Defendant McClellan Realty Corporation and all alleged liens purporting to secure the liabilities secured by such mortgages and instruments, including any judgment lien(s), are set aside as against the Trustee in Bankruptcy for Blue Coal Corporation and Glen Nan, Inc.

8. The parties' liens on real properties of Raymond Colliery Company,

Inc., described in plaintiff's Trial Exhibit 1209, incorporated herein by reference, shall be foreclosed and such properties sold upon foreclosure by an officer of this Court pursuant to 28 U.S.C. Sections 2001, 2002 and 2004 and 26 U.S.C. Section 74003(d) to satisfy the lien claims of the parties.

9. The guarantee mortgages executed in favor of IIT and assigned to McClellan Realty Co. purporting to encumber the real properties of Raymond Colliery and its subsidiaries, are hereby adjudged and decreed to be void, and of no effect, and the mortgagee, McClellan Realty Co., is hereby ordered to mark such guarantee mortgages satisfied of record within 30 days of the date of this order.

10. This decree is a final order within the meaning of Rule 54(b) of the Federal Rules of Civil Procedure as to



all of the matters set forth above, this Court having expressly determined that there is no just reason for delay or entry of a final judgment with respect to such matters and the Clerk of Court is directed hereby to enter this order as a final judgment as to such matters.

11. This Court will retain jurisdiction over all other matters, including, inter alia, the distribution of the proceeds of the litigation, the payment of costs of suit and any receiver's fees and expenses, any fees and expenses of any counsel who may be appointed by the Court for any receiver, and the determination of the amount and priority of liens (vsia-vis all existing and future liens) which may attach to the property of Raymond Colliery between April 30, 1984 and the disposition of the lands in free and

clear sales.

/s/
MUIR, U.S. District Judge

UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF PENNSYLVANIA

UNITED STATES OF :
AMERICA, :
 :
Plaintiff : Civil No. 80-1424
 :
vs. : (Reassigned to
 : Judge Muir
GLENEAGLES INVESTMENT: 3/5/81)
CO., INC., et al., :
 :
Defendants :

Schedule A
Lien Date Required by Court
Order of April 30, 1984

SUMMARY OF LIENS ATTACHING TO
PROPERTY OF RAYMOND COLLIERY

<u>Page</u>	<u>Lien</u> <u>Priority</u>	<u>Tract</u> <u>Encumbered</u>	<u>Total</u> <u>Amount</u> <u>of Lien</u> <u>as of</u> <u>4/30/84</u>
1	Scranton Sewer Authority (Penna.)*	**	117,268.58
2	Borough of Olyphant (Penna.)*	****	2,463.07
3	Lackawanna River Basin Sewer Au- thority (Penna.)*	*****	68,040.11
4	Borough of Taylor (Penna.)*	**	1,382.50

5	McClellan Realty (Finding 418)	ALL	64,001.91
6	McClellan Realty (Lieb, Finding 166, 419)	***	531,914.84
16	Tabor Court (Finding 190, 202, 203)	**	447,033.55
30	Lackawanna River Basin Sewer Au- thority (Penna.)	*****	41,838.14
31	Lackawanna County (Penna.)	**	366,140.52
59	City of Scranton (Penna.)	**	115,381.98
68	United States	ALL	1,065,041.89
69	Commonwealth of Pennsylvania	ALL	667,871.78
70	United States	ALL	7,529,121.34
71	Commonwealth of Pennsylvania	***** ALL	1,499,696.44
72	Gleneagles Investment	**	573,137.98
78	McClellan Realty	ALL	7,855,588.65
79	Henkelman Estate	ALL	4,690.00

Grand Total, all liens:

\$ 20,950,613.28

* All parties have agreed that the municipal liens of the Scranton Sewer Authority, the Borough of Olyphant, the Lackawanna River Basin Sewer Authority, and the Borough of Taylor which predate December 16, 1976 should be given first lien status on the specific parcels involved. Under the circularity result, the Commonwealth of Pennsylvania ("Penna.") steps into the shoes of these creditors. The Commonwealth also assumes the lien position of those creditors with liens reflected on pages 30 through 67.

** The following detailed schedules identify these tracts by reference to official Lackawanna County aerial maps.

*** The data in this column are the sum of (1) the original principal amount of the lien, (2) penalties, if any, (3) interest, as of April 30, 1984, and (4) record costs, if any.

**** The tracts encumbered by the Borough of Olyphant are identified by block and lot numbers referenced on maps prepared by the Borough engineer and maintained at the offices of the Borough of Olyphant.

***** The tracts encumbered by the Lackawanna River Basin Sewer Authority are identified by parcel number on one of twenty-four detailed maps which were placed in evidence at trial.

***** Detail of the municipal liens through April 30, 1984 are found earlier in Schedule A and are not repeated between these Commonwealth of Pennsylvania liens and the Gleneagles Investment lien. Nevertheless, this is their relative

position.

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

October 22, 1986

TO: Robert J. Rosenberg, Esq.
William S. Estabrook, Esq.
Lisa A. Prager, Esq.
Michael L. Paul, Esq.
Arthur J. Rinaldi, Esq.
Michael J. Sweeney, Esq.
Robert C. Nowalis, Esq.
Joseph R. Solfanelli, Esq.
D. Alan Harris, Esq.

NOTICE OF JUDGMENT

This Court's opinion was filed and
Judgment was entered today in case Nos.
85-5636, 85-5637, 85-5649, 85-5751, 85-
5780 and 85-5781

PETITION FOR REHEARING (FRAP 40)

Your attention is specifically directed to Chapter VIII B of the Court's Internal Operative Procedures.

B. Rehearing In Banc.

Rehearing in banc is not favored and ordinarily will not be ordered except
(1) where consideration by the

Exhibit "E"

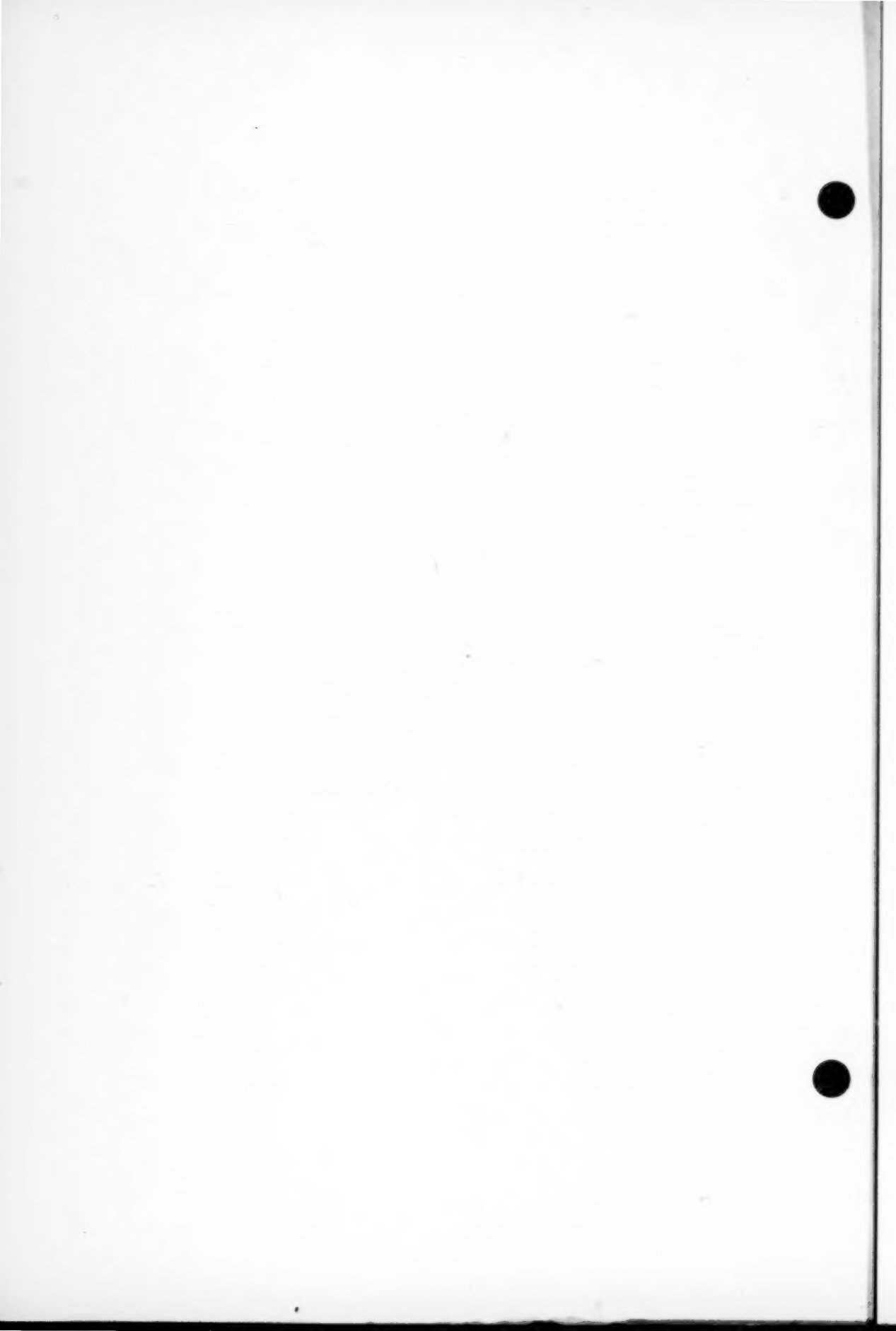
full court is necessary to secure or maintain uniformity of its decisions, or

(2) where the proceeding involves a question of exceptional importance.

This Court does not ordinarily grant rehearing in banc where the panel's statement of the law is correct and the controverted issue is solely the application of the law to the circumstances of the case.

Nor, except in rare cases, has the court granted rehearing in banc where the case was decided by a judgment order, a memorandum opinion, or unpublished per curiam opinion.

When a petition for rehearing has been filed by a party as provided by FRAP 35(b) or 40(a), unless the petition for panel rehearing under 40(a) states ex-



plicitly it does not request in banc hearing under 35(b), it is presumed that such petition requests both panel rehearing and rehearing in banc.

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

Nos. 85-5636, 85-5637, 85-5649, 85-5751,
85-5780 and 85-5781

UNITED STATES OF AMERICA

vs.

TABOR COURT REALTY CORP., McCLELLAN
REALTY CO., INC., PAGNOTTI ENTERPRISES,
INC., LOREE ASSOCIATES, JAMES J.
TEDESCO, HENRY VENTRE, LOUIS PAGNOTTI,
II, RAYMOND COLLIERY CO., INC., BLUE COAL
COMPANY, GILLEN COAL MINING CO.,
CARBONDALE COAL CO., MOFFAT PREMIUM
ANTHRACITE, NORTHWEST MINING, INC.,
MAPLE CITY COAL CO., POWDERLY
CORPORATION, CLINTON FUEL SALES, INC.,
GREAT AMERICAN COAL CO., JOSEPH
SOLFANELLI, individually and as trustee,
GENERAL ELECTRIC CREDIT CORP.,
COMMONWEALTH OF PA. DEPT. OF MINES &
MINERAL INDUSTRIES, DEPT. OF
ENVIRONMENTAL RESOURCES and DEPT. OF
REVENUE, BOROUGH OF OLYPHANT, JOHN J.
GILLEN, THOMAS J. GILLEN, ROBERT W.
CLEVELAND & SONS, INC., WILLIAM T.
KIRCHOFF, JAY W. CLEVELAND, ROYAL E.
CLEVELAND, CITY OF SCRANTON SEWER
AUTHORITY, LACKAWANNA RIVER BASIN
AUTHORITY, BOROUGH OF TAYLOR,
LACKAWANNA COUNTY, WILLIAM R.
HENKLEMAN, GLENEAGLES INVESTMENT CO.,

INC., JEDDO HIGHLAND COAL CO., OLYPHANT PREMIUM ANTHRACITE, INC., OLYPHANT ASSOCIATES, MININDU CORPORATION, GLEN NAN, INC., GILCO, INC., JAY W. CLEVELAND, As Administrator of the Estate of Royal E. Cleveland

McClellan Realty Company, Jeddo Highland Coal Co., Pagnotti Enterprises, Inc., Loree Associates, Gillen Coal Mining Co., Carbondale Coal Co., Moffatt Premium Anthracite, Northwest Mining, Inc., Maple City Coal Co., Powderly Corporation, Clinton Fuel Sales, Inc., Olyphant Premium Anthracite, Inc., Olyphant Associates, Minindu Corporation, Gilco, Inc. and Joseph Solfanelli, individually and as trustee,

Appellants in No. 85-5636

UNITED STATES OF AMERICA

vs.

TABOR COURT REALTY CORP., McCLELLAN REALTY CO., INC., PAGNOTTI ENTERPRISES, INC., LOREE ASSOCIATES, JAMES J. TEDESCO, HENRY VENTRE, LOUIS PAGNOTTI, II, RAYMOND COLLIERY CO., INC., BLUE COAL COMPANY, GILLEN COAL MINING CO., CARBONDALE COAL CO., MOFFAT PREMIUM ANTHRACITE, NORTHWEST MINING, INC., MAPLE CITY COAL CO., POWDERLY CORPORATION, CLINTON FUEL SALES, INC., GREAT AMERICAN COAL CO., JOSEPH SOLFANELLI, individually and as trustee, GENERAL ELECTRIC CREDIT CORP., COMMONWEALTH OF PA. DEPT. OF MINES & MINERAL INDUSTRIES, DEPT. OF ENVIRONMENTAL RESOURCES and DEPT. OF

REVENUE, BOROUGH OF OLYPHANT, JOHN J. GILLEN, THOMAS J. GILLEN, ROBERT W. CLEVELAND & SONS, INC., WILLIAM T. KIRCHOFF, JAY W. CLEVELAND, ROYAL E. CLEVELAND, CITY OF SCRANTON SEWER AUTHORITY, LACKAWANNA RIVER BASIN AUTHORITY, BOROUGH OF TAYLOR, LACKAWANNA COUNTY, WILLIAM R. HENKLEMAN, GLENEAGLES INVESTMENT CO., INC., JEDDO HIGHLAND COAL CO., OLYPHANT PREMIUM ANTHRACITE, INC., OLYPHANT ASSOCIATES, MININDU CORPORATION, GLEN NAN, INC., GILCO, INC., JAY W. CLEVELAND, As Administrator of the Estate of Royal E. Cleveland

James J. Haggerty, Trustee in Bankruptcy
for Blue Coal Corporation and Glen Nan,
Inc.,

Appellant in No. 85-5637

UNITED STATES OF AMERICA

vs.

TABOR COURT REALTY CORP., McCLELLAN REALTY CO., INC., PAGNOTTI ENTERPRISES, INC., LOREE ASSOCIATES, JAMES J. TEDESCO, HENRY VENTRE, LOUIS PAGNOTTI, II, RAYMOND COLLIERY CO., INC., BLUE COAL COMPANY, GILLEN COAL MINING CO., CARBONDALE COAL CO., MOFFAT PREMIUM ANTHRACITE, NORTHWEST MINING, INC., MAPLE CITY COAL CO., POWDERLY CORPORATION, CLINTON FUEL SALES, INC., GREAT AMERICAN COAL CO., JOSEPH SOLFANELLI, individually and as trustee, GENERAL ELECTRIC CREDIT CORP., COMMONWEALTH OF PA. DEPT. OF MINES &

MINERAL INDUSTRIES, DEPT. OF
 ENVIRONMENTAL RESOURCES and DEPT. OF
 REVENUE, BOROUGH OF OLYPHANT, JOHN J.
 GILLEN, THOMAS J. GILLEN, ROBERT W.
 CLEVELAND & SONS, INC., WILLIAM T.
 KIRCHOFF, JAY W. CLEVELAND, ROYAL E.
 CLEVELAND, CITY OF SCRANTON SEWER
 AUTHORITY, LACKAWANNA RIVER BASIN
 AUTHORITY, BOROUGH OF TAYLOR,
 LACKAWANNA COUNTY, WILLIAM R.
 HENKLEMAN, GLENEAGLES INVESTMENT CO.,
 INC., JEDDO HIGHLAND COAL CO., OLYPHANT
 PREMIUM ANTHRACITE, INC., OLYPHANT
 ASSOCIATES, MININDU CORPORATION, GLEN
 NAN, INC., GILCO, INC., JAY W. CLEVELAND, As
 Administrator of the Estate of Royal E. Cleveland

The United States.

Appellant in No. 85-5649

UNITED STATES OF AMERICA

vs.

TABOR COURT REALTY CORP., McCLELLAN
 REALTY CO., INC., PAGNOTTI ENTERPRISES,
 INC., LOREE ASSOCIATES, JAMES J.
 TEDESCO, HENRY VENTRE, LOUIS PAGNOTTI,
 II, RAYMOND COLLIERY CO., INC., BLUE COAL
 COMPANY, GILLEN COAL MINING CO.,
 CARBONDALE COAL CO., MOFFAT PREMIUM
 ANTHRACITE, NORTHWEST MINING, INC.,
 MAPLE CITY COAL CO., POWDERLY
 CORPORATION, CLINTON FUEL SALES, INC.,
 GREAT AMERICAN COAL CO., JOSEPH
 SOLFANELLI, individually and as trustee,
 GENERAL ELECTRIC CREDIT CORP.,
 COMMONWEALTH OF PA. DEPT. OF MINES &

MINERAL INDUSTRIES. DEPT. OF ENVIRONMENTAL RESOURCES and DEPT. OF REVENUE, BOROUGH OF OLYPHANT, JOHN J. GILLEN, THOMAS J. GILLEN, ROBERT W. CLEVELAND & SONS, INC., WILLIAM T. KIRCHOFF, JAY W. CLEVELAND, ROYAL E. CLEVELAND, CITY OF SCRANTON SEWER AUTHORITY, LACKAWANNA RIVER BASIN AUTHORITY, BOROUGH OF TAYLOR, LACKAWANNA COUNTY, WILLIAM R. HENKLEMAN, GLENEAGLES INVESTMENT CO., INC., JEDDO HIGHLAND COAL CO., OLYPHANT PREMIUM ANTHRACITE, INC., OLYPHANT ASSOCIATES, MININDU CORPORATION, GLEN NAN, INC., GILCO, INC., JAY W. CLEVELAND, As Administrator of the Estate of Royal E. Cleveland

McClellan Realty Corporation and other Defendants.

Appellants in No. 85-5751

UNITED STATES OF AMERICA

vs.

TABOR COURT REALTY CORP., McCLELLAN REALTY CO., INC., PAGNOTTI ENTERPRISES, INC., LOREE ASSOCIATES, JAMES J. TEDESCO, HENRY VENTRE, LOUIS PAGNOTTI, II, RAYMOND COLLIERY CO., INC., BLUE COAL COMPANY, GILLEN COAL MINING CO., CARBONDALE COAL CO., MOFFAT PREMIUM ANTHRACITE, NORTHWEST MINING, INC., MAPLE CITY COAL CO., POWDERLY CORPORATION, CLINTON FUEL SALES, INC., GREAT AMERICAN COAL CO., JOSEPH SOLFANELLI, individually and as trustee, GENERAL ELECTRIC CREDIT CORP.,

COMMONWEALTH OF PA. DEPT. OF MINES &
 MINERAL INDUSTRIES, DEPT. OF
 ENVIRONMENTAL RESOURCES and DEPT. OF
 REVENUE, BOROUGH OF OLYPHANT, JOHN J.
 GILLEN, THOMAS J. GILLEN, ROBERT W.
 CLEVELAND & SONS, INC., WILLIAM T.
 KIRCHOFF, JAY W. CLEVELAND, ROYAL E.
 CLEVELAND, CITY OF SCRANTON SEWER
 AUTHORITY, LACKAWANNA RIVER-BASIN
 AUTHORITY, BOROUGH OF TAYLOR,
 LACKAWANNA COUNTY, WILLIAM R.
 HENKLEMAN, GLENEAGLES INVESTMENT CO.,
 INC., JEDDO HIGHLAND COAL CO., OLYPHANT
 PREMIUM ANTHRACITE, INC., OLYPHANT
 ASSOCIATES, MININDU CORPORATION, GLEN
 NAN, INC., GILCO, INC., JAY W. CLEVELAND, As
 Administrator of the Estate of Royal E. Cleveland

The United States,

Appellant in No. 85-5780

UNITED STATES OF AMERICA

vs.

TABOR COURT REALTY CORP., McCLELLAN
 REALTY CO., INC., PAGNOTTI ENTERPRISES,
 INC., LOREE ASSOCIATES, JAMES J.
 TEDESCO, HENRY VENTRE, LOUIS PAGNOTTI,
 II, RAYMOND COLLIERY CO., INC., BLUE COAL
 COMPANY, GILLEN COAL MINING CO.,
 CARBONDALE COAL CO., MOFFAT PREMIUM
 ANTHRACITE, NORTHWEST MINING, INC.,
 MAPLE CITY COAL CO., POWDERLY
 CORPORATION, CLINTON FUEL SALES, INC.,
 GREAT AMERICAN COAL CO., JOSEPH
 SOLFANELLI, individually and as trustee,
 GENERAL ELECTRIC CREDIT CORP.,

COMMONWEALTH OF PA. DEPT. OF MINES &
 MINERAL INDUSTRIES, DEPT. OF
 ENVIRONMENTAL RESOURCES and DEPT. OF
 REVENUE, BOROUGH OF OLYPHANT, JOHN J.
 GILLEN, THOMAS J. GILLEN, ROBERT W.
 CLEVELAND & SONS, INC., WILLIAM T.
 KIRCHOFF, JAY W. CLEVELAND, ROYAL E.
 CLEVELAND, CITY OF SCRANTON SEWER
 AUTHORITY, LACKAWANNA RIVER BASIN
 AUTHORITY, BOROUGH OF TAYLOR,
 LACKAWANNA COUNTY, WILLIAM R.
 HENKLEMAN, GLENEAGLES INVESTMENT CO.,
 INC., JEDDO HIGHLAND COAL CO., OLYPHANT
 PREMIUM ANTHRACITE, INC., OLYPHANT
 ASSOCIATES, MININDU CORPORATION, GLEN
 NAN, INC., GILCO, INC., JAY W. CLEVELAND, As
 Administrator of the Estate of Royal E. Cleveland

James J. Haggerty, Trustee in Bankruptcy
 for Blue Coal Corporation and Glen Nan,
 Inc.,

Appellant in No. 85-5781

Appeal from the United States District
 Court for the Middle District
 of Pennsylvania - Scranton
 (D.C. Civil No. 84-1424)

Argued
 September 10, 1986
 Before: ALDISERT, *Chief Judge*,
 and HIGGINBOTHAM and HUNTER,
Circuit Judge.

OPINION OF THE COURT
(Filed October 22, 1986)

Roger M. Olsen
Assistant Attorney General
Michael L. Paul
William S. Estabrook
Lisa A. Prager (ARGUED)
Attorneys
Tax Division
Department of Justice
Post Office Box 502
Washington, D.C. 20044
James J. West
United States Attorney
Of Counsel

COUNSEL FOR THE UNITED STATES

Robert J. Rosenberg, Esq. (ARGUED)
Latham & Watkins
885 Third Avenue
New York, New York 10022

Bernard Ouziel, Esq.
111 West 57th Street
Room 1120
New York, New York 10019

Joseph R. Solfanelli, Esq.
Gerald J. Butler, Esq.
Solfanelli & Butler
Penn Security Bank Building
Suite 800
Scranton, Pa. 18503

COUNSEL FOR MC CLELLAN REALTY
CO., INC. ET AL

Doran, Nowalis & Flanagan
 Robert C. Nowalis, Esq. (ARGUED)
 700 Northeastern Bank Building
 69 Public Square
 Wilkes-Barre, Pa. 18701

COUNSEL FOR JAMES J. HAGGERTY,
 ESQ., TRUSTEE IN BANKRUPTCY
 FOR BLUE COAL CORPORATION AND
 GLEN NAN, INC.

A. Bruce Schimberg, Esq.
 Frank R. Kennedy, Esq.
 Michael J. Sweeney, Esq.
 Richard B. Kapnick, Esq.
 Sidley & Austin
 One First National Plaza
 Chicago, Ill. 60603

COUNSEL FOR NATIONAL COMMERCIAL
 FINANCE ASSOCIATION, INC.

OPINION OF THE COURT

ALDISERT, *Chief Judge.*

We have consolidated appeals from litigation involving one of America's largest anthracite coal producers that emanate from a district court bench trial that extended over 120 days and recorded close to 20,000 pages of transcript. Ultimately, we have to decide whether the court erred in entering judgment in favor of the United States in reducing to judgment certain federal corporate tax assessments made against the coal producers, in determining the priority of the government liens, and in permitting foreclosure on the liens. To reach these questions, however, we must examine a very intricate leveraged buy-out and decide whether mortgages given in the transaction were fraudulent conveyances within the meaning of

the constructive and intentional fraud sections of the Pennsylvania Uniform Fraudulent Conveyances Act (UFCA), 39 Pa. Cons. Stat. §§ 354-357, and if so, whether a later assignment of the mortgages was void as against creditors.

The district court made 481 findings of facts and issued three separate published opinions: *United States v. Gleneagles Investment Co.*, 565 F. Supp. 556 (M.D. Pa. 1983) (*Gleneagles I*); 571 F. Supp. 935 (1983) (*Gleneagles II*); and 584 F. Supp. 671 (1984) (*Gleneagles III*). We are told that this case represents the first significant application of the UFCA to leveraged buy-out financing.

We will address seven issues presented by the appellants and an amicus curiae, the National Commercial Finance Association, and by the United States and a trustee in bankruptcy as cross appellants:

- whether the court erred in applying the UFCA to a leveraged buy-out;
- whether the court erred in denying the mortgage assignee, McClellan Realty, a "lien superior to all other creditors";
- whether the court erred in "collapsing" two separate loans for the leveraged buy-out into one transaction;
- whether the court erred in holding that the mortgages placed by the borrowers on November 26, 1973 were invalid under the UFCA;
- whether the court erred in holding that the mortgages placed by the guarantors were invalid for lack of fair consideration;
- in the government's cross-appeal, whether the court erred in determining that the

mortgage assignee, McClellan Realty, was entitled to an equitable lien for municipal taxes paid; and

- in the government's and trustee in bankruptcy's cross-appeal, whether the court erred in placing the mortgage assignee, McClellan Realty, on the creditor list rather than removing it entirely.

We will summarize a very complex factual situation and then discuss these issues seriatim.

I.

These appeals arise from an action by the United States to reduce to judgment delinquent federal income taxes, interest, and penalties assessed and accrued against Raymond Colliery Co., Inc. and its subsidiaries (the Raymond Group) for the fiscal years of June 30, 1966 through June 30, 1973 and to reduce to judgment similarly assessed taxes owed by Great American Coal Co., Inc. and its subsidiaries for the fiscal year ending June 30, 1975.

The government sought to collect these tax claims from surface and coal lands owned by the Raymond Group as well as from lands formerly owned by it but which, as a result of allegedly illegal and fraudulent county tax sales, were later owned by Gleneagles Investment Co., Inc. In addition, the government sought to assert the priority of its liens over liens held by others. The district court held in favor of the government on most of its claims and concluded the litigation by promulgating an order of priority of liens on Raymond Group lands.

Raymond Colliery, incorporated in 1962, was owned by two families, the Gillens and the Clevelands. It owned over 30,000 acres of land in Lackawanna and Luzerne counties in Pennsylvania and was one of the

largest anthracite coal producers in the country. In 1966, Glen Alden Corporation sold its subsidiary, Blue Coal Corporation, to Raymond for \$6 million. Raymond paid \$500,000 in cash and the remainder of the purchase price with a note secured by a mortgage on Blue Coal's land. Lurking in the background of the financial problems present here are two important components of the current industrial scene: first, the depressed economy attending anthracite mining in Lackawanna and Luzerne Counties, the heartland of this industry; and second, the Pennsylvania Department of Environmental Resources' 1967 order directing Blue Coal to reduce the amount of pollutants it discharged into public waterways in the course of its deep mining operations, necessitating a fundamental change from deep mining to strip or surface mining.

Very serious problems surfaced in 1971 when Raymond's chief stockholders -- the Gillens and Clevelands -- started to have disagreements over the poor performance of the coal producing companies. The stockholders decided to solve the problem by seeking a buyer for the group. On February 2, 1972, the shareholders granted James Durkin, Raymond's president, an option to purchase Raymond for \$8.5 million. The stockholders later renewed Durkin's option at a reduced price of \$7.2 million.

Durkin had trouble in raising the necessary financing to exercise his option. He sought help from the Central States Pension Fund of the International Brotherhood of Teamsters and also from the Mellon Bank of Pittsburgh. Mellon concluded that Blue Coal was a bad financial risk. Moreover, both Mellon and Central States held extensive discussions with Durkin's counsel concerning the legality of encumbering Raymond's assets for the purpose of obtaining the loan, a loan which was not to be used to

repay creditors but rather to buy out Raymond's stockholders.

After other unsuccessful attempts to obtain financing for the purchase, Durkin incorporated a holding company, Great American, and assigned to it his option to purchase Raymond's stock. Although the litigation in the district court was far-reaching, most of the central issues have their genesis in 1973 when the Raymond Group was sold to Durkin in a leveraged buy-out through the vehicle of Great American.

A leveraged buy-out is not a legal term of art. It is a shorthand expression describing a business practice wherein a company is sold to a small number of investors, typically including members of the company's management, under financial arrangements in which there is a minimum amount of equity and a maximum amount of debt. The financing typically provides for a substantial return of investment capital by means of mortgages or high risk bonds, popularly known as "junk bonds." The predicate transaction here fits the popular notion of a leveraged buy-out. Shareholders of the Raymond Group sold the corporation to a small group of investors headed by Raymond's president; these investors borrowed substantially all of the purchase price at an extremely high rate of interest secured by mortgages on the assets of the selling company and its subsidiaries and those of additional entities that guaranteed repayment.

To effectuate the buy-out, Great American obtained a loan commitment from Institutional Investors Trust on July 24, 1973, in the amount of \$8,530,000. The 1973 interrelationship among the many creditors of the Raymond Group, and the sale to Great American -- a seemingly empty corporation which was able to perform the buy-out only on the



strength of the massive loan from IIT -- forms the backdrop for the relevancy of the Pennsylvania Uniform Fraudulent Conveyance Act, one of the critical legal questions presented for our decision.

Durkin obtained the financing through one of his two partners in Great American.¹ The loan from IIT was structured so as to divide the Raymond Group into borrowing companies and guarantor companies. The loan was secured by mortgages on the assets of the borrowing companies, but was also guaranteed by mortgages on the assets of the guarantor companies. We must decide whether the borrowers' mortgages were invalid under the UFCA and whether there was consideration for the guarantors' mortgages.

The IIT loan was closed on November 26, 1973. The borrowing companies in the Raymond Group received \$7 million in direct proceeds from IIT. The remaining \$1.53 million was placed in escrow as a reserve account for the payment of accruing interest. The loans were to be repaid by December 31, 1976, at an interest rate of five points over the prime rate but in no event less than 12.5 percent. In exchange, each of the borrowing companies -- Raymond Colliery, Blue Coal, Glen Nan, and Olyphant Associates -- created a first lien in favor of IIT on all of their tangible and intangible assets; each of the guarantor companies -- all other companies in the Raymond Group -- created a second lien in favor of IIT on all of their tangible and intangible assets. The loan agreement also contained a clause which provided

1. Durkin owned 40% of Great American. Hyman Green owned 10%, and James R. Hoffa, Jr. owned the remaining 50%. Durkin and Green concealed Hoffa's ownership interest in Great American from IIT. Hoffa apparently came into the picture when Durkin attempted to borrow money from the Central States Pension Fund of the International Brotherhood of Teamsters to finance the purchase.

IIT with a priority lien on the proceeds from Raymond's sales of its surplus lands. Finally, the agreement provided that violations of any of the loan covenants would permit IIT to accelerate the loan and to collect immediately the full balance due from any or all of the borrowers or guarantors.

The exchange of money and notes did not stop with IIT's advances to the borrowing companies. Upon receipt of the IIT loan proceeds, the borrowing companies immediately transferred a total of \$4,085,000 to Great American. In return, Great American issued to each borrowing company an unsecured promissory note with the same interest terms as those of the IIT loan agreement. In addition to the proceeds of the IIT loan, Great American borrowed other funds to acquire the purchase price for Raymond's stock.

When the financial dust settled after the closing on November 26, 1973, this was the situation at Raymond: Great American paid \$6.7 million to purchase Raymond's stock, the shareholders receiving \$6.2 million in cash and a \$500,000 note; at least \$4.8 million of this amount was obtained by mortgaging Raymond's assets.

Notwithstanding the cozy accommodations for the selling stockholders, the financial environment of the Raymond Group at the time of the sale was somewhat precarious. At the time of the closing, Raymond had multi-million dollar liabilities for federal income taxes, trade accounts, pension fund contributions, strip mining and back-filling obligations, and municipal real estate taxes. The district court calculated that the Raymond Group's existing debts amounted to at least \$20 million on November 26, 1983. 565 F. Supp. at 578.

Under Durkin's control after the buy-out, Raymond's condition further deteriorated. Following the closing the Raymond Group lacked the funds to pay its routine operating expenses, including those for materials, supplies, telephone, and other utilities. It was also unable to pay its delinquent and current real estate taxes. Within two months of the closing, the deep mining operations of Blue Coal were shut down; within six months of the closing, the Raymond Group ceased all strip mining operations. Consequently, the Raymond Group could not fulfill its existing coal contracts and became liable for damages for breach of contract. The plaintiffs in the breach of contract actions exercised their right of set-off against accounts they owed the Raymond Group. Within seven months of the closing, the Commonwealth of Pennsylvania and the Anthracite Health & Welfare Fund sued the Raymond Group for its failures to fulfill back-filling requirements in the strip mining operations and to pay contributions to the Health & Welfare Fund. This litigation resulted in injunctions against the Raymond Group companies which prevented them from moving or selling their equipment until their obligations were satisfied. Moreover, Lackawanna and Luzerne counties announced their intent to sell the Raymond Group properties for unpaid real estate taxes. Finally, on September 15, 1976, IIT notified the borrowing and guarantor Raymond companies that their mortgage notes were in default. On September 29, 1976, IIT confessed judgments against the borrowing companies for the balance due on the loan and began to solicit a buyer for the Raymond Group mortgages.

New dramatis personae came on stage and orchestrated additional financial dealings which led to the purchase of the IIT mortgages. These dealings form the backdrop for additional legal issues to be decided

here. Pagnotti Enterprises, another large anthracite producer, was the prime candidate to purchase the mortgages from IIT. In December 1976, James J. Tedesco, on behalf of Pagnotti, commenced negotiations for the purchase. Tedesco signed an agreement on December 15, 1976. Pursuant to the mortgage sale contract -- and prior to the closing of the sale and assignment of the mortgages -- IIT and Pagnotti each placed \$600,000 in an escrow account to be applied to the payment of delinquent real estate taxes on properties listed for the county tax sales or to be used as funds for bidding on the properties at the tax sales.

IIT and Pagnotti agreed that bidding on the properties at the Lackawanna and Luzerne county tax sales would be undertaken by nominee corporations. Pursuant to their agreement, more new business entities then entered the picture. Tabor Court Realty was formed to bid on Raymond's properties at the Lackawanna County tax sale; similarly, McClellan Realty was formed to bid on Blue Coal's lands in Luzerne County. Pagnotti prepaid the delinquent taxes that predated IIT's mortgages to Lackawanna County. On December 17, 1976, Tabor Court Realty obtained Raymond's Lackawanna lands for a bid of \$385,000; yet by this date an involuntary petition in bankruptcy had been filed against Blue Coal, a chief Raymond subsidiary, by its creditors. A similar proceeding was instituted against another subsidiary, Glen Nan. Based on the failure of Tabor Court to pay other delinquent taxes, on December 16, 1980, Lackawanna County held a second tax sale of Raymond's lands. At that sale, Joseph Solfaneli, acting on behalf of Gleneagles Investment, bid and acquired Raymond's lands for \$535,290.39. These transactions did not stand up. At trial, the parties stipulated that both

county tax sales were invalid and that Raymond's lands purportedly sold to Tabor Court and Gleneagles remained assets owned by Raymond.

On January 26, 1977, the sale and assignment of the IIT mortgages took place. Pagnotti paid approximately \$4.5 million for the IIT mortgages; at that time, the mortgage balance was \$5,817,475.69. Pagnotti thereafter assigned the mortgage to McClellan, thus making McClellan a key figure in this litigation. On December 12, 1977, Hyman Green, one of Durkin's co-shareholders in Raymond, was told that McClellan intended to sell, at a private sale, many of Raymond's assets encumbered as collateral on the IIT mortgages. McClellan did just that -- it foreclosed. On February 28, 1978, in a private sale, Loree Associates purchased the assets from McClellan for \$50,000. This sale was not advertised nor were the assets offered to any other parties. Additionally, the sale was not recorded on the books of either Loree Associates or McClellan until May 1983, six months after the start of the litigation below. Nor was this the only private sale. On October 6, 1978, McClellan foreclosed on the stock of Raymond and sold it at a private sale for \$1 to Joseph Solfanelli, as trustee for Pagnotti. Again, the sale was not advertised nor was anyone other than Green informed of the sale. No appraisals were obtained for either the stock or the collateral purportedly sold by McClellan at these sales.

This, then, constitutes a summary of the adjudicative facts that undergird the litigation below and the appeals before us.

II.

The instant action was commenced by the United States on December 12, 1980 to reduce to judgment certain corporate federal tax assessments made

against the Raymond Group and Great American. The government sought to assert the priority of its tax liens and to foreclose against the property that Raymond had owned at the time of the assessments as well as against properties currently owned by Raymond. The United States argued that the IIT mortgages executed in November 1973 should be set aside under the Uniform Fraudulent Conveyance Act and further that the purported assignment of these mortgages to Pagnotti should be voided because at the inception Pagnotti had purchased the mortgages with knowledge that they had been fraudulently conveyed.

As heretofore stated, after a bench trial, the district court issued three separate published opinions. In *Gleneagles I*, 565 F. Supp. 556 (1983), the court concluded, *inter alia*, that the mortgages given by the Raymond Group to IIT on November 26, 1973 were fraudulent conveyances within the meaning of the constructive and intentional fraud sections of the Pennsylvania Uniform Fraudulent Conveyances Act, 39 Pa. Cons. Stat. §§ 354-357. In *Gleneagles II*, 571 F. Supp. 935 (1983), the court further held that the mortgages to McClellan Realty were void as against the other Raymond Group creditors. In its third opinion, 584 F. Supp. 671 (1984), the court set out the priority of the creditors. The court granted McClellan and Tabor Court an equitable lien ahead of the creditors for the Pennsylvania municipal taxes they paid in Raymond's behalf prior to the 1976 Lackawanna county tax sale of Raymond's properties. However, the court placed McClellan, as assignee of the IIT mortgages, near the bottom of the list of creditors. The trustee in bankruptcy of Blue Coal and Glen Nan argues that McClellan's rights are totally invalidated and that McClellan has no standing whatsoever as a creditor.

The Raymond Group -- four coal mining companies that executed the mortgages (Raymond Colliery, Blue Coal, Glen Nan, and Olyphant Associates) as well as interrelated associated companies that had placed guarantee mortgages and subsidiaries of such associated companies -- has appealed. As heretofore stated, all these mortgages, subsequently invalidated by the district court, had been granted to IIT on November 26, 1973 and assigned by IIT to appellant McClellan. For the purpose of this appeal, we shall refer to the Raymond Group as "appellants", or "McClellan".

Jurisdiction was proper in the trial court. 28 U.S.C. §§ 1340, 1345. We are satisfied that jurisdiction on appeal is proper based on 28 U.S.C. § 1291. Although one or two parties have questioned the timeliness of McClellan's appeal based on a contention that partially defective service of McClellan's motion for a new district court trial failed to toll the running of the 60-day period for filing appeals under Rule 4(a)(1) of the Federal Rules of Appellate Procedure, we are satisfied that this was not fatal. See *Thompson v. INS*, 375 U.S. 384 (1964).

III.

McClellan initially challenges the district court's application of the Pennsylvania Uniform Fraudulent Conveyances Act (UFCA), 29 Pa. Cons. Stat. §§ 351-363, to the leveraged buy-out loan made by IIT to the mortgagors, and to the acquisition of the mortgages from IIT by McClellan. The district court determined that IIT lacked good faith in the transaction because it knew, or should have known, that the money it lent the mortgagors was used, in part, to finance the purchase of stock from the mortgagors' shareholders, and that as a consequence of the loan, IIT and its assignees obtained a secured

position in the mortgagors' property to the detriment of creditors. Because this issue involves the interpretation and application of legal precepts, review is plenary. *Universal Minerals, Inc. v. C.A. Hughes & Co.*, 669 F.2d 98, 102 (3d Cir. 1981).

In applying section 353(a) of the UFCA, the district court stated:

The initial question . . . is whether the transferee, IIT, transferred its loan proceeds in good faith. . . . IIT knew or strongly suspected that the imposition of the loan obligations secured by the mortgages and guarantee, mortgages would probably render insolvent both the Raymond Group and each individual member thereof. In addition, IIT was fully aware that no individual member of the Raymond Group would receive fair consideration within the meaning of the Act in exchange for the loan obligations to IIT. Thus, we conclude that IIT does not meet the standard of good faith under Section 353(a) of the Act. See e.g., *Cohen v. Sutherland*, 257 F.2d at 742 (transferee's knowledge that the transferor is insolvent defeats assertion of good faith); *Epstein v. Goldstein*, 107 F.2d 755, 757 (2d Cir. 1939) (transferee's knowledge that no consideration was received by transferor relevant to the issue of good faith).

565 F. Supp. at 574.

McClellan argues that "the only reasonable and proper application of the good faith criteria as it applies to the lender in structuring a loan is one which looks to the lender's *motives* as opposed to his *knowledge*." Br. for appellants at 17. McClellan argues that good faith is satisfied when "the lender acted in an arms-length transaction without ulterior motive or collusion with the debtor to the detriment of creditors." *Id.*



Section 354 of the UFCA is a "constructive fraud" provision. It establishes that a conveyance made by a person "who is or will be thereby rendered insolvent, is fraudulent as to creditors, without regard to his actual intent, if the conveyance is made . . . without a fair consideration." 39 Pa. Cons. Stat. § 354. Section 353 defines fair consideration as an exchange of a "fair equivalent . . . in good faith." 39 Pa. Cons. Stat. § 353. Because section 354 excludes an examination of intent, it follows that "good faith" must be something other than intent; because section 354 also focuses on insolvency, knowledge of insolvency is a rational interpretation of the statutory language of lack of "good faith." McClellan would have us adopt "without ulterior motive or collusion with the debtor to the detriment of creditors" as the good faith standard. We are uneasy with such a standard because these words come very close to describing intent.

Surprisingly, few courts have considered this issue. In *Epstein v. Goldstein*, 107 F.2d 755, 757 (2d Cir. 1939), the court held that because a transferee had no knowledge of the transferor's insolvency, it could not justify a finding of bad faith, implying that a showing of such knowledge would support a finding of bad faith. In *Sparkman and McClean Co. v. Derber*, 4 Wash. App. 341, 481 P.2d 585 (1971), the court considered a mortgage given to an attorney by a corporation on the verge of bankruptcy to secure payment for his services. The trial court found that the transaction had violated section 3 of the UFCA (here, section 353) because it had been made in bad faith. On appeal the Washington Court of Appeals stated that "prior cases . . . have not precisely differentiated the good faith requirement . . . of fair consideration [in UFCA section 3] from the actual intent to defraud requirement of [UFCA section 7]." *Id.* at ___, 481 P.2d

at 589. The court then set forth a number of factors to be considered in determining good faith: 1) honest belief in the propriety of the activities in question; 2) no intent to take unconscionable advantage of others; and 3) no intent to, or knowledge of the fact that the activities in question will, hinder, delay, or defraud others. *Id.* at ___, 481 P.2d at 591. Where "any one of these factors is absent, lack of good faith is established and the conveyance fails." *Id.* See also *Wells Fargo Bank v. Desert View Bldg. Supplies, Inc.*, 475 F. Supp. 693, 696-97 (D. Nev. 1978) (lender lacked good faith when exchanging its securities for preexisting loans in context of an impending bankruptcy), *aff'd mem.*, 633 F.2d 225 (9th Cir. 1980).

We have decided that the district court reached the right conclusion here for the right reasons. It determined that IIT did not act in good faith because it was aware, first, that the exchange would render Raymond insolvent, and second, that no member of the Raymond Group would receive fair consideration. We believe that this determination is consistent with the statute and case law.

McClellan and amicus curiae also argue that as a general rule the UFCA should not be applied to leveraged buy-outs. They contend that the UFCA, which was passed in 1924, was never meant to apply to a complicated transaction such as a leveraged buy-out. The Act's broad language, however, extends to any "conveyance" which is defined as "every payment of money . . . and also the creation of any lien or incumbrance." 39 Pa. Cons. Stat. § 351. This broad sweep does not justify exclusion of a particular transaction such as a leveraged buy-out simply because it is innovative or complicated. If the UFCA is not to be applied to leveraged buy-outs, it should be for the state legislatures, not the courts, to decide.

In addition, although appellants' and amicus curiae's arguments against general application of the Act to leveraged buy-outs are not without some force, the application of fraudulent conveyance law to certain leveraged buy-outs is not clearly bad public policy.² In any event, the circumstances of this case justify application. Even the policy arguments offered against the application of fraudulent conveyance law to leveraged buy-outs assume facts that are not present in this case. For example, in their analysis of fraudulent conveyance law, Professors Baird and Jackson assert that their analysis should be applied to leveraged buy-outs only where aspects of the transaction are not hidden from creditors and the transaction does not possess other suspicious attributes. See Baird and Jackson, *Fraudulent Conveyance Law and Its Proper Domain*, 38 Vand. L. Rev. 829, 843 (1985). In fact,

2. A major premise of the policy arguments opposing application of fraudulent conveyance law to leveraged buy-outs is that such transactions often benefit creditors and that the application of fraudulent conveyance law to buy-outs will deter them in the future. See Baird and Jackson, *Fraudulent Conveyance Law and Its Proper Domain*, 38 Vand. L. Rev. 829, 855 (1985). An equally important premise is that creditors can protect themselves from undesirable leveraged buy-outs by altering the terms of their credit contracts. *Id.* at 835. This second premise ignores, however, cases such as this one in which the major creditors (in this instance the United States and certain Pennsylvania municipalities) are involuntary and do not become creditors by virtue of a contract. The second premise also ignores the possibility that the creditors attacking the leveraged buy-out (such as many of the creditors in this case) became creditors before leveraged buy-outs became a common financing technique and thus may not have anticipated such leveraged transactions so as to have been able to adequately protect themselves by contract. These possibilities suggest that Baird and Jackson's broad proscription against application of fraudulent conveyance law to leveraged buy-outs may not be unambiguously correct.

Baird and Jackson conclude their article by noting that their analysis is limited to transactions in which "the transferee parted with value when he entered into the transaction and that transaction was entered in the ordinary course." *Id.* at 855 (footnote omitted). In the instant case, however, the severe economic circumstances in which the Raymond Group found itself, the obligation, without benefit, incurred by the Raymond Group, and the small number of shareholders benefited by the transaction suggest that the transaction was not entered in the ordinary course, that fair consideration was not exchanged, and that the transaction was anything but unsuspecting. The policy arguments set forth in opposition to the application of fraudulent conveyance law to leveraged buy-outs do not justify the exemption of transactions such as this.³

IV.

McClellan next argues that under section 359(2) of the UFCA, it is entitled to a lien superior to all other creditors on Raymond's property. *Br.* for appellants at 27. Once again, review of this issue is plenary. *Universal Minerals*, 669 F.2d at 102.

3. It should also be noted that another basic premise of the Baird and Jackson analysis is that as a general matter fraudulent conveyance law should be applied only to those transactions to which a rational creditor would surely object. Baird and Jackson, at 834. Although a rational creditor might under certain circumstances consent to a risky but potentially beneficial leveraged buy-out of a nearly insolvent debtor, no reasonable creditor would consent to the intentionally fraudulent conveyance the district court correctly found this transaction to be. Thus, the application of fraudulent conveyance law to the instant transaction appears consistent even with Baird and Jackson's analysis.

A.

Section 359 establishes a two-tier system to protect certain purchasers from the effects of the UFCA. Section 359(1) permits a purchaser who has paid "fair consideration without knowledge of the fraud at the time of the purchase" to maintain the conveyance as valid against a creditor. 39 Pa. Cons. Stat. § 359(1). Section 359(2) of the Act specifies that a "purchaser who, without actual fraudulent intent, has given less than a fair consideration for the conveyance or obligation may retain the property or obligation as security for repayment." 39 Pa. Cons. Stat. § 359(2).

In *Gleneagles II*, the district court found that Pagnotti, who purchased the IIT mortgages for \$4,047,786 and transferred them to McClellan Realty, was not entitled to protection under section 359(1). The court determined that although Pagnotti had given a "fair equivalent" for the IIT mortgages, it did not do so without knowledge of the fraud at the time of the purchase. 571 F. Supp. at 952.

In *Gleneagles III*, the district court concluded that McClellan, Pagnotti's assignee, was not entitled to the partial protection of section 359(2). The court stated that although it had found in *Gleneagles II* that Pagnotti had not acted in good faith in acquiring the IIT mortgages, this was not equivalent to a finding that Pagnotti had given "less than fair consideration." 584 F. Supp. at 682. The court, however, also implied that notwithstanding its finding that Pagnotti had not acted with "actual fraudulent intent," it had not "purchased the IIT mortgages in good faith." *Id.* The court ruled that good faith is at least required to merit protection under section 359(2). The court therefore found that Pagnotti was not entitled to such protection. *Id.*

McClellan faults this reasoning with an argument that, at least facially, seems persuasive. It argues that the district court's finding that Pagnotti acted with knowledge of the fraud means that Pagnotti acted without good faith and therefore paid "less than fair consideration" as defined by section 353 of the Act. Therefore, McClellan reasons, absent a finding of "actual fraudulent intent," it is entitled to protection under section 359(2).

Admittedly, section 359(2) is inartfully drafted and a literal reading of the section could conceivably command this result. We believe, however, that the public policy behind the UFCA compels a different interpretation. The Act protects both *purchasers* and *third parties*. We see a distinction here. The Act protects those *purchasers*, who, without actual fraudulent intent and without a lack of good faith, have paid less than a fair equivalent for the property received. Conversely, the Act does not protect purchases having a fraudulent intent or a lack of good faith. We are not satisfied that the UFCA affords third parties greater protection than purchasers. The purposes of the Act would be nullified if third parties who in bad faith paid less than a fair equivalent could take the property in a better position than an original purchaser who at the outset had engaged in a fraudulent transfer. See e.g., *Dealers Discount Corp. v. Vantar Properties, Inc.*, 45 Misc. 2d 49, 50, 256 N.Y.S.2d 257, 259 (1964).

We are most uneasy with an interpretation that would deny rights to the purchaser, Pagnotti, but confer them on its assignee, McClellan. Such a literal reading of the statute's language would require us to ignore the statute's purpose. We are reminded of Judge Roger J. Traynor's advice, "We need literate, not literal judges."

B.

Moreover, we find support in analogizing to the federal bankruptcy laws. Section 548(c) of the Bankruptcy Code -- the successor to section 67(d)(6) of the Bankruptcy Act -- provides that a transferee or obligee of a fraudulent transfer or obligation who takes for value and in good faith may retain the interest transferred or the obligation incurred. 11 U.S.C. § 548(c)⁴. This section of the Bankruptcy Code thus closely tracks section 359(2) of the UFCA. Indeed, bankruptcy's leading commentator explains that: "The major similarity between the Bankruptcy Code and the UFCA is reflected in the portion of subsection [548(c)] that permits the good faith transferee or obligee to retain his lien." 4 Collier on Bankruptcy ¶ 548.07, at 548-65 (15th ed. 1986). McClellan acknowledges that "[t]he fraudulent conveyance provisions of the Code are modeled on the UFCA, and uniform interpretation of the two statutes [is] essential to promote commerce nationally. *Cohen v. Sutherland*, 257 F.2d 737, 741 (2d Cir. 1958)" Br. for appellants at 29.

In two cases similar to the one at bar, courts have denied protection to lenders under section 67(d) of the Bankruptcy Act because, although their conduct was not intentionally fraudulent, the lenders exhibited a lack of good faith. *In re Allied Development Corp.*, 435 F.2d 372, 376 (7th Cir. 1970); *In re Venie*, 80 F. Supp. 250, 256 (W.D. Mo. 1948). The same principles should apply here to deny protection to Pagnotti where the record supports the district court's findings that Pagnotti lacked good faith. See *The Uniform Fraudulent Conveyance Act in Pennsylvania*, 5 U. Pitt. L. Rev. 161, 186 (1939) (Section 359(2) language

4. "Fair consideration" is defined under Section 353 of the Bankruptcy Code as an exchange of fair equivalents in good faith.

without actual fraudulent intent" should mean without knowledge).

C.

McClellan next challenges the district court's finding that as Pagnotti's assignee, it too, lacked good faith, and therefore was disqualified from protection under the Act. McClellan states that "[t]he District Court never suggests, much less finds, that McClellan's dealings with IIT concerning its purchase of the mortgages were anything but at arms-length." Br. for appellants at 25. The district court's determination that McClellan lacked good faith is a factual finding reviewed on the clearly erroneous standard. *Krasnov v. Dinan*, 465 F.2d 1298, 1299-1300 (3d Cir. 1972).

Although McClellan attempts to distance itself from Pagnotti, the party that purchased the mortgages from IIT and assigned them to McClellan, it cannot do this successfully. A well-recognized rule provides that an assignee gets only those rights held by its assignor and no more. The district court clearly held that Pagnotti did not obtain the mortgages in good faith. *Gleneagles II*, 571 F. Supp. at 952. The court supported its findings with facts from the record. See *id.* at 952-56. Because McClellan's rights as an assignee are no greater than Pagnotti's and because McClellan does not show how the district court's finding of Pagnotti's lack of good faith was clearly erroneous, McClellan is charged with the same quality of faith.⁵

5. McClellan also argues that under section 359(3), no duty was imposed on it, or its assignor, Pagnotti, to make an inquiry into the circumstances of the sale. Section 359(3) provides that:

(3) Knowledge that a conveyance has been made as a gift or for nominal consideration shall not by itself be deemed to be knowledge that the

D.

McClellan also presents two arguments that relate to the amount of recovery by the creditors. It argues first that it is entitled to credit for \$6.1 million that Raymond shareholders Gillen and Cleveland paid to the creditors and the Commonwealth in settlement of prior actions against those shareholders. The district court found that:

The Creditors have claimed in this litigation that the Gillen and Cleveland Defendants are liable for sales of Raymond Group assets made after November 26, 1973 to satisfy the Raymond Group's debt to IIT and others. There is no basis for this Court to apply the \$6,100,000 paid by the Gillens and Clevelands to particular injuries suffered by the Creditors as the result of the fraudulent conveyances. Moreover, the settlement agreements provided that the monies paid were also in settlement of other lawsuits by the Creditors and the Commonwealth against the Gillens and Clevelands. There is no basis on the present record for a conclusion by this Court that the \$6,100,000 paid by the Gillens and Clevelands pursuant to the settlement agreements was intended solely to compensate the Creditors and the Commonwealth for

conveyance was a fraud on any creditor of the grantor, or impose any duty on the person purchasing the property from the grantee to make inquiry as to whether such conveyance was or was not a fraud on any such creditor.

39 Pa. Cons. Stat. § 359(3). However, Pagnotti's knowledge went far beyond mere knowledge "that a conveyance has been made as a gift or for nominal consideration." See *Gleneagles II*, 571 F. Supp. at 952-58.

damages flowing from the Gillens' and Cleveland's acceptance of the IIT loan proceeds on November 26, 1973.

Gleneagles III, 584 F. Supp. at 682.

We agree. The settlement agreement terms are very specific. The United States agreed to release the "Cleveland Group" from all claims. The agreement defined the Cleveland Group as: "Robert W. Cleveland & Sons, Inc., William T. Kirchoff, Jay W. Cleveland and the Estate of Royal E. Cleveland, as well as any members of either the Robert W. or Royal E. Cleveland families against whom claims by the creditors might be asserted." App. at 480. None of these individuals or entities are currently parties to this action. Any effort by the remaining defendants to come within, or to benefit from, the settlement agreement is clearly not justified by the terms thereof. See app. at 479-84.

E.

McClellan next contends that the district court erred in not crediting McClellan for that portion of the IIT loan that was not passed through to Raymond's shareholders: although "the District Court acknowledged that \$2,915,000, or approximately 42 percent, of the IIT loan proceeds originally went for the benefit of . . . creditors, IIT and McClellan received no credit therefor in regard to the partial validity of their liens." Br. for appellants at 28. McClellan argues the district court determined that "[t]he wrong committed upon the creditors . . . [was] the diversion of some 58 percent of the loan proceeds from the IIT loan to [Raymond's] shareholders." *Id.* at 29. It concludes that to invalidate the entire mortgage would be to provide Raymond's creditors with a "double recovery." *Id.* at 28. We understand the dissent to agree with McClellan's analysis when noting that "'creditors have

causes of action in fraudulent conveyance law only to the extent they have been damaged.'" Dissenting typescript at ____ (citations omitted).

McClellan and, by implication, the dissent mischaracterize the district court's findings and conclusions regarding the fraudulent nature of the IIT loans. The district court did not determine that the loan transaction was only partially -- or, to use McClellan's formulation, 58% -- fraudulent. Nor did the district court conclude that Raymond's creditors had been wronged by only a portion of the transaction. Instead, the district court stated that:

McClellan Realty's argument rests on the incorrect assumption that some portions of the IIT mortgages are valid as against the Creditors. In *Gleneagles I*, 565 F. Supp. at 580, 586, this Court found that IIT and Durkin engaged in an intentionally fraudulent transaction on November 26, 1973. The IIT mortgages are therefore invalid in their entirety as to creditors.

Gleneagles III, 584 F. Supp. at 683. In essence, the district court ruled that the *aggregate* transaction was fraudulent, notwithstanding the fact that a portion of the loan proceeds was allegedly used to pay existing creditors.

This determination is bolstered by the fact that most of the \$2,915,000 allegedly paid to the benefit of Raymond's creditors went to only one creditor -- Chemical Bank. In *Gleneagles I*, the district court found that \$2,186,247 of the IIT loan proceeds were paid to Chemical Bank in satisfaction of the mortgage that Raymond had taken to purchase Blue Coal (a Raymond subsidiary). See 565 F. Supp. at 570, 571 (findings 132(k) and 140). The purpose of this payment is of critical significance:

The Gillens and the Clevelands [Raymond's shareholders] required satisfaction of the Chemical Bank mortgage as a condition of the sale of their Raymond Colliery stock at least in part because Royal Cleveland had personally guaranteed repayment of that loan.

Id. at 571 (finding 141). McClellan does not challenge this finding on appeal. Thus, of the \$2.9 million allegedly paid to benefit Raymond's creditors, \$2.2 million were actually intended to benefit Raymond's shareholders and to satisfy a condition for the sale. The remaining amounts allegedly paid to benefit Raymond's creditors were applied to the closing costs of the transaction. See *id.* at 570 (finding 133).

On this record, the district court's characterization of the transaction as a whole as fraudulent cannot reasonably be disputed. The court's consequent determination that the "IIT mortgages are . . . invalid in their entirety as to creditors" is supported by precedent. See *Newman v. First National Bank*, 76 F.2d 347, 350-51 (3d Cir. 1935).⁶

Moreover, as the district court correctly noted, it sits in equity when fashioning relief under the UFCA. *Gleneagles III*, 584 F. Supp. at 682. Consequently, our

6. On broadly analogous facts, the *Newman* court found that a defendant bank's fraudulent conduct rendered its judgment against a debtor "wholly void":

Therefore, the whole of it should be set aside. Setting aside only the more vicious part (the \$3,500 sham loan) is not enough. It was the act of the Bank in obtaining the judgment by fraud not the amount of the judgment that defeated the [creditor] recovering on its judgment.

Newman v. First National Bank, 76 F.2d 347, 350-51 (3d Cir. 1935) (emphasis added).

review of the district court's action is severely limited. *Evans v. Buchanan*, 555 F.2d 373, 378 (3d Cir. 1977), cert. denied, 434 U.S. 880 (1977).

The district court determined that "[t]he Creditors . . . would not be placed in the same or similar position which they held with respect to the Raymond Group in 1973 merely by replacing the \$4,085,500 of IIT loan proceeds that were misused on November 26, 1973." *Gleneagles III*, 584 F. Supp. at 681. We agree with the district court and are persuaded that this court's decision in *Newman* controls. In *Newman* we held that where a creditor was prevented from recovering on its judgment as a result of a fraudulent scheme between the debtor and another creditor, a judgment obtained by the defrauding creditor was totally void. We stated that "[i]f we extract from the fraudulent actors every advantage which they derived from their fraud and restore the creditor to the position which lawfully belonged to it at the time the fraud was perpetrated and give it all rights which, but for the fraud, it had under the law, we feel that equity would adequately be done." *Id.* at 350. Here, the district court found that only by voiding the entire amount could the creditors be placed in the same position they held before the November 26, 1973 misuse of the loans. To the extent that this determination was based on facts, we do not view them as clearly erroneous; to the extent the conclusion was based on law, we find no error. Consequently, we do not believe that the district court's equitable remedy was "arbitrary, fanciful, or unreasonable," or the product of "improper standards, criteria, or procedures." *Evans*, 555 F.2d at 378.

For the above reasons, therefore, we will not disturb the district court's determination that McClellan is not entitled to a "lien superior to all other

creditors" as the assignee of all or part of the IIT mortgages.⁷

V.

McClellan, joined by the amicus, next argues that the district court erred "by collapsing two separate loans into one transaction." Br. for appellants at 30. The loan arrangement was a two-part process: the loan proceeds went from IIT to the borrowing Raymond Group companies, which immediately turned the funds over to Great American, which used the funds for the buy-out. McClellan contends that the district

7. Moreover, even if we were to adopt the analysis of McClellan and the dissent and accept the argument that the IIT mortgages should not be invalidated to the extent that the loan proceeds benefitted Raymond's creditors, we would not conclude that only \$4,085,000 of the mortgages should be set aside. McClellan and the dissent apportion the IIT loan proceeds into three categories: \$4,085,000 conveyed to Raymond shareholders; \$1,530,900 retained by IIT as interest reserve; and \$2,915,000 used to pay existing creditors. McClellan and the dissent concede at least for the purposes of argument that \$4,085,000 was fraudulently conveyed; they contend that the other amounts benefitted Raymond's creditors. To the extent that the \$1,530,000 interest reserve was applied to that portion of the loan that passed to Raymond's shareholders, however, it did not benefit Raymond's creditors. Thus, even under McClellan's and the dissent's analysis, some portion (e.g., 58%) of the IIT mortgages used to fund the \$1,530,000 million interest reserve should be invalidated. In addition, McClellan and the dissent ignore the implications of the fact that most of the \$2,915,000 allegedly paid to the benefit of Raymond's creditors went to Chemical Bank. See *infra*, at 35-36.

Finally, it must be remembered that IIT recovered over \$4.5 million of its loans through repayments from the Raymond Group companies. *Gleneagles III*, 584 F. Supp. at 683. We agree with the district court that, "even assuming that a valid portion of the IIT mortgages originally existed, that portion was extinguished by the payments on the debt in excess of that portion made by the mortgagors before the assignment of the IIT mortgages." *Id.*

court erred by not passing on the fairness of the transaction between IIT and the Raymond Group mortgagors. Review of this issue is plenary. *Universal Minerals*, 669 F.2d at 102.

Contrary to McClellan's contentions, the district court did examine this element of the transaction, stating: "[W]e find that the obligations incurred by the Raymond Group and its individual members to IIT were not supported by fair consideration. The mortgages and guarantee mortgages to secure these obligations were also not supported by fair consideration." *Gleneagles I*, 565 F. Supp. at 577 (emphasis supplied).

Admittedly, in the course of its determination that the IIT-Raymond Group transaction was without fair consideration under section 353(a), the court looked beyond the exchange of funds between IIT and the Raymond Group. But there was reason for this. The two exchanges were part of one integrated transaction. As the court concluded: "[t]he \$4,085,000 in IIT loan proceeds which were lent immediately by the borrowing companies to Great American were merely passed through the borrowers to Great American and ultimately to the selling stockholders and cannot be deemed consideration received by the borrowing companies." *Id.* at 575.

The district court's factual findings support its treatment of the IIT-Raymond Group-Great American transaction as a single transaction. For example, Durkin, president of Great American, solicited financing from IIT for the purchase. *Id.* at 566 (finding 70). The loan negotiations included representatives of all three parties. *Id.* at 567 (findings 83-87). The first closing was aborted by IIT's counsel because of, *inter alia*, concern about "unknown individuals" involved with Great American. *Id.* at 567-68 (finding 89(a)). The

\$7 million loaned by IIT to the borrowing companies was "immediately placed in an escrow account"; "simultaneously" with the receipt of the IIT proceeds, the borrowing companies loaned Great American the cash for the buy-out and received in return "an unsecured note promising to repay the loans to the borrowing companies on the same terms and at the same interest rate as pertained to the loans to the borrowing companies from IIT." *Id.* at 570 (findings 127-29).

Appellant cannot seriously challenge these findings of fact. We are satisfied with the district court's conclusion that the funds "merely passed through the borrowers to Great American." This necessitates our agreement with the district court's conclusion that, for purposes of determining IIT's knowledge of the use of the proceeds under section 353(a), there was one integral transaction.⁸

VI.

McClellan next faults the district court's determination that the Raymond Group was rendered insolvent by "the IIT transaction and the instantaneous payment to the selling stockholders of a substantial portion of the IIT loan in exchange for their stock." *Gleneagles I*, 565 F. Supp. at 580. McClellan disputes the method of computation used by the district court. The question of insolvency is a mixed

8. Admittedly, McClellan's and amicus' arguments could have some validity where the lender is unaware of the use to which loans proceeds are to be put. That is not the case here. IIT was intimately involved with the formulation of the agreement whereby the proceeds of its loan were funnelled into the hands of the purchasers of the stock of a corporation that was near insolvency. Try as they might to distance themselves from the transaction now, they cannot rewrite history.

question of law and fact. Our review of the legal portions of the issue is plenary, while review of the factual portion is according to the clearly erroneous standard. *Universal Minerals*, 669 F.2d at 102.

A.

Section 352 of the UFCA defines insolvency as "when the present, fair, salable value of [a person's] assets is less than the amount that will be required to pay his probable liability on his existing debts as they become absolute and matured." 39 Pa. Cons. Stat. § 352(1). As heretofore stated, the district court calculated the Raymond Group's existing debts as "at least \$20,000,000 on November 26, 1973." *Gleneagles I*, 565 F. Supp. at 578. The court then compared Raymond's debt to the "present, fair, salable value" of its assets and found the Group insolvent. *Id.* at 578-80. In doing so, the court relied on *Larrimer v. Feeney*, where the Pennsylvania Supreme Court stated:

A reasonable construction of the . . . statutory definition of insolvency indicates that it not only encompasses insolvency in the bankruptcy sense i. e. a deficit net worth, but also includes a condition wherein a debtor has insufficient presently salable assets to pay existing debts as they mature. If a debtor has a deficit net worth, then the present salable value of his assets must be less than the amount required to pay the liability on his debts as they mature. A debtor may have substantial paper net worth including assets which have a small salable value, but which if held to a subsequent date could have a much higher salable value. Nevertheless, *if the present salable value of [his] assets [is] less than the amount required to*

pay existing debts as they mature the debtor is insolvent.

411 Pa. 604, 608, 192 A.2d 351, 353 (1963) (emphasis supplied, citation omitted). Guided by this teaching, the court found that: (1) the Raymond Group's coal production, which had been unprofitable since 1969, "could not produce a sufficient cash flow to pay the company's obligations in a timely manner"; (2) the sale of the Raymond Group's surplus lands, which had provided a substantial cash flow, was "abruptly cut off" by the terms of the IIT agreement; and (3) sale of its equipment could not generate adequate cash to meet Raymond's existing debts as they matured. *Gleneagles I*, 565 F. Supp. at 579-80. These determinations are the factual components of the insolvency finding; McClellan contends that at least one of the findings is clearly erroneous.

B.

McClellan challenges the second of these determinations, arguing that under Montana and New York law, "[p]roper application of § 352(1) requires the valuation of an asset at its *present value*, provided it can be liquidated within a reasonably immediate period of time -- not its value if liquidated immediately." Br. for appellants at 37 (citing *Duncan v. Landis*, 106 F. 839 (3d Cir. 1901); *In re Crystal Ice & Fuel Co.*, 283 F. 1007 (D. Mont. 1922); *Tumarkin v. Gallay*, 127 F. Supp. 94 (S.D.N.Y. 1954)). McClellan argues that the court's characterization of "Raymond Group's vast lands, culm banks, and coal reserves [as] . . . highly illiquid assets which could not be sold except over an extended period of time," 565 F. Supp. at 579, was clearly erroneous. However, the court did not disregard the potential of these lands. It applied the *Larrimer* criteria of Pennsylvania, not those of

Montana or New York. It held that sale of these lands would have been insufficient to meet Raymond's debts as they matured:

[The] cash flow [from land sales] was abruptly cut off by the IIT agreement which provided that, for the land sales which occurred in 1974 and 1975, IIT would receive a total of \$1,832,500 of the first \$2,500,000 of land sale proceeds received by the Raymond Group. The remaining proceeds of \$667,500 would be placed by IIT in a "funded reserve" and would be used to pay the Raymond Group's creditors. However, if the lands were taxed as ordinary income to the Raymond Group, which was exceedingly likely and in fact came to pass, each land sale would result in a cash loss to the Raymond Group as the amount of federal taxes due would exceed the funds allocated to the "funded reserve" from that sale. Moreover, no cash would be available for creditors other than IIT, the Ford Motor Credit Co. and Thrift Credit from the sale of surplus lands. Thus, the cash that could be generated by the operation of the Raymond Group's business was grossly insufficient to meet its obligations.

Id. We conclude that McClellan has not demonstrated that this finding was clearly erroneous. We are satisfied that the district court followed the guidance of Pennsylvania courts in analyzing the Raymond Group's insolvency. Its application of the law was not in error, nor were its factual determinations clearly erroneous.

VII.

McClellan next argues that the district court erred in holding that the mortgages were invalid under



section 357 of the UFCA. 39 Pa. Cons. Stat. § 357. Review of this issue is plenary. *Universal Minerals*, 669 F.2d at 102.

As distinguished from the "constructive fraud" sections of the UFCA discussed *supra*, section 357 invalidates conveyances made with an intent to defraud creditors: "Every conveyance made and every obligation incurred with actual intent, as distinguished from intent presumed in law, to hinder, delay, or defraud either present or future creditors, is fraudulent as to both present and future creditors." 39 Pa. Const. Stat. § 357. Under Pennsylvania law, an intent to hinder, delay, or defraud creditors may be inferred from transfers in which consideration is lacking and where the transferer and transferee have knowledge of the claims of creditors and know that the creditors cannot be paid. *Godina v. Oswald*, 206 Pa. Super. 51, 55, 211 A.2d 91, 93 (1965). Direct evidence is not necessary to prove "actual intent." *Continental Bank v. Marcus*, 242 Pa. Super. 371, 377, 363 A.2d 1318, 1321 (1976). In Pennsylvania, the existence of actual intent is a question of fact, *Golder v. Bogash*, 325 Pa. 449, 452, 188 A. 837, 838 (1937); therefore, the court's determination is reviewed on the clearly erroneous standard. *Krasnov v. Dinan*, 465 F.2d 1298, 1299-1300 (3d Cir. 1972).

A.

The evidence recited by the district court supports its finding of an intent to hinder creditors. McClellan does not challenge the sufficiency of this evidence, but rather its application, arguing that from this evidence the court inferred intent, and that inferences and presumptions are proscribed by section 357. This argument was rejected by the Pennsylvania courts in *Godina v. Oswald*, 206 Pa. Super. 51, 211 A.2d 91

(1965). There, the court ruled that "[s]ince fraud is usually denied, it must be inferred from all facts and circumstances surrounding the conveyance, including subsequent conduct." *Id.* at 55, 211 A.2d at 93 (quoting *Shefflt v. Koff*, 175 Pa. Super. 37, 41, 100 A.2d 393, 395 (1953)). This is precisely what the district court did here. See *Gleneagles I*, 565 F. Supp. at 580-83.

B.

Appellant also objects to the district court's statement that "[i]f the parties could have foreseen the effect on creditors resulting from the assumption of the IIT obligation by the Raymond Group . . . the parties must be deemed to have intended the same." 565 F. Supp. at 581. McClellan argues that the court erred in applying the concept of foreseeability, an issue only relevant to negligence. This presents a slightly more troublesome question, because we believe that one of the cases cited by the district court does not support the challenged statement. See *Chorost v. Grand Rapids Factory Show Rooms, Inc.*, 172 F.2d 327, 329 (3d Cir. 1949) (actual fraud may be found on the basis of circumstantial evidence notwithstanding willful ignorance of defrauding parties). We do find support, however, in *In re Process-Manz Press, Inc.*, 236 F. Supp. 333 (N.D. Ill. 1964), also cited by the district court. That case does not address foreseeability, but relies on the proposition that a party is deemed to have intended the natural consequences of his acts. *Id.* at 347. We are satisfied that this principle supports the district court's conclusion.⁹

9. Furthermore, even if the error were not harmless, it would not effect the outcome because the court's conclusion that the transfer violated the constructive fraud provision of section 354 was correct. A section 357 violation is cumulative only.

C.

We conclude that the court's finding on intent was not clearly erroneous.

VIII.

Finally, McClellan challenges the district court's invalidation of the guarantee mortgages. The district court invalidated these mortgages because the guarantors did not receive fair consideration. 565 F. Supp. at 577.

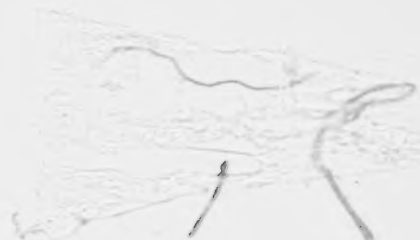
McClellan, relying on *Telefest, Inc. v. VU-TV, Inc.*, 591 F. Supp. 1368 (D.N.J. 1984), argues that the guarantors were so closely associated with the borrower companies that they received sufficient indirect consideration from the benefits to the borrowing companies. In *Telefest*, however, the existence of fair consideration was undisputed. See *id.* at 1370. The court held that the cross-collateral guarantor company also benefitted from the fair consideration provided to the borrowers. *Id.* at 1378-79. The consideration in the underlying transaction here, however, was determined to be deficient. Any indirect benefit to guarantor companies deriving from that consideration would, *a fortiori*, also be deficient. The district court did not err in so holding.

IX.

We now turn to the cross appeals.

A.

The government argues that the district court erred in finding that Pagnotti, who had paid real estate taxes prior to the Lackawanna and Luzerne County tax sales, is entitled to an equitable lien for the municipal taxes that it paid. During the litigation the parties



stipulated that the purported county tax sales were invalid, and that ownership based on the tax sales was invalid. The district court reasoned that:

Raymond Colliery's Commonwealth and pre-1974 real estate taxes were first liens on the lands of Raymond Colliery and were paid by L. Robert Lieb when the Pagnotti Defendants were neither owners of the land nor owners of the IIT mortgages. Because of this Court's conclusion in *Gleneagles II* that the 1976 tax sale was invalid, the 1976 Tabor Court bid on the lands of Raymond Colliery was tantamount to a payment of Raymond Colliery's real estate taxes and likewise was also a payment made before the Pagnotti Defendants owned the lands of Raymond Colliery or the IIT mortgages. These tax payments discharged liens on the lands of Raymond Colliery which were ahead of those claimed by the United States. Equitably, the Pagnotti Defendants should now receive a lien position reflecting these tax payments ahead of the lien position accorded the United States. Likewise, because the above tax payments by the Pagnotti Defendants discharged liens ahead of the liens claimed in this litigation by the various counties and other municipalities, the Pagnotti Defendants should receive liens reflecting the tax payments ahead of those lienors.

. . . [T]he April 1977 payment to the City of Scranton should be treated in the same manner as the 1976 tax sale bid.

Gleneagles III, 584 F. Supp. at 685.

When fashioning equitable relief, such as here, a court acts with broad discretion. *Lacks v. Fahmi*, 623 F.2d 254, 256 (2d Cir. 1980). We therefore review the

district court's decision to grant an equitable lien for abuse of discretion, which "exists only when the judicial action is arbitrary, fanciful, or unreasonable, or when improper standards, criteria, or procedures are used." *Evans v. Buchanan*, 555 F.2d 373, 378 (3d Cir. 1977), cert. denied, 434 U.S. 880 (1977).

In *Newman v. First National Bank*, 76 F.2d 347 (3d Cir. 1935), we held that even a grantee guilty of intentional fraud was entitled to be paid, prior to other creditors, from the sale proceeds of the subject property for the amount of taxes the grantee had paid as owner of the subject property. *Id.* at 351. The district court found that the taxes for which payments were made, both prior to and at the 1976 tax sale, constituted prior liens for taxes or the upset price (past due taxes) owing against the parcels of land which were the subject of the 1976 tax sale. *Gleneagles II*, 571 F. Supp. at 947-49 (findings 166, 188, 190). These findings are not challenged. Based on *Newman*, the district court did not act in an "arbitrary, fanciful, or unreasonable" manner in granting McClellan an equitable lien for the taxes it paid on Raymond property, prior to the liens of other creditors.

B.

The United States and cross-appellant trustee in bankruptcy for two major Raymond Group companies, Blue Coal Corporation and Glen Nan, complain that the court erred by awarding McClellan a place on the creditors' list as assignee of the IIT mortgages, albeit number 16 in a list of 17 liens. The court determined that this priority lien reflected \$17,319,326.58, the amount claimed by McClellan to be due on the direct mortgages assigned by IIT to it, including principal and interest. *Gleneagles III*, 584 F. Supp. at 688. See also *id.* at 678 (finding 462). Cross appellants argue

that under section 9-504 of the Pennsylvania Uniform Commercial Code, the IIT mortgages should be invalidated in their entirety and that McClellan is entitled to no recognition in the order of liens. Review of this issue is plenary. *Universal Minerals, Inc.*, 669 F.2d at 102.

The Uniform Commercial Code confers upon a secured party the right, upon default, to dispose of collateral by sale or lease, subject to the requirement that "every aspect of the disposition including the method, manner, time, place and terms must be commercially reasonable." 13 Pa. Con. Stat. § 9504. When a private sale of repossessed collateral has been made, and the debtor raises the question of the commercial reasonableness of that sale, the great weight of authority holds that the burden of proof is shifted to the secured party seeking a deficiency judgment to show that, under the totality of circumstances, the disposition of collateral was commercially reasonable. *United States v. Willis*, 593 F.2d 247, 258 (6th Cir. 1979); see cases collected in 59 A.L.R.3d, 378-80 (1974) (reasonableness of disposition of collateral); 69 Am. Jur. 2d *Secured Transactions* § 623, pp. 530-31 (1973). Here the district court found that the McClellan's foreclosure sales of Raymond's assets were commercially unreasonable. *Gleneagles III*, 584 F. Supp. at 690 (conclusion 37).

When there has been a commercially unreasonable disposition of collateral, the effect of that disposition upon a creditor's entitlement to recovery of remaining debt must be considered. Pennsylvania courts have held that "failure to establish commercial reasonableness of the resale price creates a presumption that the value of the collateral equalled the indebtedness secured, thereby extinguishing the

indebtedness unless the secured party rebuts the "presumption." *Savoy v. Beneficial Consumer Discount Co.*, 503 Pa. 74, 78, 468 A.2d 465, 467 (1983).

Cross appellants argue, and McClellan does not dispute, that McClellan failed to produce any evidence regarding the value of the property sold in its foreclosure sales of Raymond's assets to rebut the *Savoy* presumption. It will be remembered that at a private sale McClellan sold certain Raymond assets to Loree Associates for \$50,000, and all of the Raymond's stock to Joseph Solfanelli, as trustee for Pagnotti, for \$1. *Gleneagles III*, 584 F. Supp. at 676 (findings 429-30). McClellan responds that the UCC is not intended to have a punitive effect and that consequently "[t]he rebuttable presumption rule is inapplicable here for it is not appropriate or fair to impose such a drastic, punitive measure upon McClellan." Reply Br. for appellants at 24.

We nevertheless believe that *Savoy* controls. There the creditor had failed to rebut the presumption, absent evidence of the value of the collateral, that the value of the collateral sold equals the indebtedness. The *Savoy* trial court took judicial notice of the market value of the collateral, but on appeal the Pennsylvania Supreme Court adopted a strict interpretation of the statute and invalidated the creditor's lien *in toto*: "[Creditor's] entitlement to a deficiency judgment has been extinguished by its failure to rebut the presumption as to the value of the collateral." 503 Pa. at 79-80, 468 A.2d at 468. Because the district court found McClellan's sale of the Raymond collateral commercially unreasonable, *Savoy* requires that we reverse the district court's decision in *Gleneagles III* to the extent that it recognizes McClellan's status as a creditor as against the trustee in bankruptcy. To the

extent that the district court recognized a mortgage lien, see 584 F. Supp. at 688, as distinguished from an equitable lien representing county tax payment, the district court erred in failing to invalidate the mortgage lien completely.

X.

We have carefully considered all the contentions of appellants and cross appellants. The judgment of the district court will be affirmed in all respects, except we will vacate that portion of ¶ 4 of the final order and judgment, app. at 173, relating to the McClellan mortgage lien set forth as Number 16 in priority, see 584 F. Supp. at 688, and remand these proceedings with a direction that an order be entered declaring void the assigned IIT mortgages and other security instruments of McClellan as against the trustee in bankruptcy and further declaring that as to the trustee, McClellan possesses no rights as a creditor with respect to the putative assignment of the IIT mortgages.

I concur in the majority's judgment that Pennsylvania's fraudulent conveyance laws may be applied to the leveraged buyout where, as here, a few shareholders seek to use it as a device to benefit themselves and take advantage of the creditors of a clearly faltering corporation. Since I find that the purposes underlying Pennsylvania's fraudulent conveyance law dictate that only a portion of the disputed transfer of funds be set aside, however, I must dissent from that part of the majority's opinion which declares the IIT mortgage loans wholly void.

The basic objective of fraudulent conveyance law is to preserve estates and to prevent them from being wrongfully drained of assets. See *Melamed v. Lake County National Bank*, 727 F.2d 1399, 1401 (6th Cir. 1984). Fraudulent conveyance law is not intended to add to estates for the unjustified benefit of creditors. In fact, "creditors have causes of action in fraudulent conveyance law only to the extent they have been damaged." *A/S Kreditt-Finans v. Cia Venetivno De Navagacion*, 560 F.Supp. 705, 711 (E.D.Pa. 1983), *aff'd*, 729 F.2d 1446 (3d Cir. 1984). IIT made four separate loans totaling \$8,530,000. Of this, \$4,085,000 was passed through Raymond Group companies to shareholders and \$1,530,000 was retained by IIT as an interest reserve as part of the invalid transaction. \$2,915,000, however, was used to pay existing debts (including an existing mortgage loan owned by Chemical Bank). To the extent that the IIT funds were used to pay existing creditors, the assets available to creditors generally were not diminished and the Raymond Group's estate was not improperly depleted.¹ I would therefore hold that only the transfer of the \$4,085,000 between IIT and the Raymond Group's shareholders and the creation of the \$1,500,000 interest reserve for IIT should be set aside.

1. It is clear that Pennsylvania's fraudulent conveyance laws would have permitted the Raymond Group to take out a loan to pay existing debts. *Trumbower Co. v. Noe Construction Corp.*, 64 D. & C. 2d 480 (1973). To an extent, this is what the Raymond Group did with IIT loan proceeds.



A True Copy:

Teste:

*Clerk of the United States Court of Appeals
for the Third Circuit*

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

Nos. 85-5636, 85-5637, 85-5649,
85-5751, 85-5780 and 85-5781

UNITED STATES OF AMERICA

v.

TABOR COURT REALTY CORP., et al.

Appeal from the United States District
Court for the Middle District
of Pennsylvania - Scranton
(D.C. Civil No. 80-1424)

Argued
September 10, 1986
Before: ALDISERT, *Chief Judge*,
and HIGGINBOTHAM and HUNTER,
Circuit Judges.

ORDER AMENDING OPINION

IT IS ORDERED that the slip opinion of this Court
filed October 22, 1986, be amended as follows:

(1) On page 48, after the first full paragraph, a
sentence inserted to read as follows:

"A. LEON HIGGINBOTHAM, JR., *Circuit Judge*,
concurring in part and dissenting in part."

(2) On page 48, last full paragraph, third line, the
phrase "the leveraged buyout" be changed to "a
leverage buyout."

Exhibit "F"

(3) On page 49, first full paragraph, sixteenth line, the phrase "\$2,915,000, however," be changed to "However, \$2,915,000."

(4) On page 49, first full paragraph, last line, the figure "\$1,500,000" be changed to "\$1,530,000."

BY THE COURT.

/s/ A. Leon Higginbotham, Jr.

Circuit Judge

DATED: October 24, 1986

A True Copy:

Teste:

*Clerk of the United States Court of Appeals
for the Third Circuit*

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

Nos. 85-5636, 85-5637, 85-5649, 85-5751,
85-5780 & 85-5781

UNITED STATES OF AMERICA

vs.

TABOR COURT REALTY CORP., ET AL.

(M.D. Pa. Civil No. 84-1424)

SUR PETITION FOR REHEARING

Present: ALDISERT, Chief Judge, and
SEITZ, ADAMS, GIBBONS, WEIS, HIGGIN-
BOTHAM, BECKER, STAPLETON, MANSMANN, and
Hunter, Circuit Judges. *

The petition for rehearing filed by Appellants/Cross Appellees in the above entitled case having been submitted to the judges who participated in the decision of this court and to all other available circuit judges of the circuit in regular active service, and no judge who concurred in the decision having asked for rehearing, and a majority of

the circuit judges of the circuit in regular active service not having voted for rehearing by the court in banc, the petition for rehearing is denied.

BY THE COURT,

/S/

Chief Judge

DATED: Nov. 24, 1986

Cross References

Arrest in civil cases, see sections 252 and 296 of Title 12, Civil and Equitable Remedies and Procedure.

Attachment,

Ground of, see section 2711 of Title 12, Civil and Equitable Remedies and Procedure.

Recovery of property, see section 2805 of Title 12, Civil and Equitable Remedies and Procedure.

Creditor's right to attack judgment conferred by debtor, see sections 911 and 912 of Title 12, Civil and Equitable Remedies and Procedure.

Deeds executed out of state not recorded within six months, see section 445 of Title 21, Deeds and Mortgages.

Uniform Interparty Agreement Act as affecting, see section 553 of Title 21, Deeds and Mortgages.

Unrecorded deeds as fraud against subsequent bona fide purchasers, etc., see section 443 of Title 21, Deeds and Mortgages.

§ 351. Definition of terms

In this act, "assets" of a debtor means property not exempt from liability for his debts; to the extent that any property is liable for any debts of the debtor, such property shall be included in his assets.

"Conveyance" includes every payment of money, assignment, release, transfer, lease, mortgage, or pledge of tangible or intangible property, and also the creation of any lien or incumbrance.

"Creditor" is a person having any claim, whether matured or unmatured, liquidated or unliquidated, absolute, fixed, or contingent.

"Debt" includes any legal liability, whether matured or unmatured, liquidated or unliquidated, absolute, fixed, or contingent. 1921, May 21, P.L. 1045, No. 379, § 1.

Historical Note

Section 14 of this act repeals all inconsistent acts or parts of acts. Said section 14 further provides that "nothing herein shall be deemed to modify or repeal" act of 1905, March 28, P.L. 62, "entitled 'An act relative to the sale in bulk of the whole, or a large part, of a stock of merchandise and fixtures, or merchandise, or fixtures, not in the ordinary course of business; providing certain requirements therefor; imposing certain duties upon the seller; and making their violation a misdemeanor.'"

The Governor in his approval of this act, states that there is a formal de-

fect in section 14, "in that it recites the so-called 'Bulk Sales Act,' of March 28, 1905, which was repealed by the act of May 23, 1919."

Uniform Act:

This section is identical with the provisions of section 1 of the Uniform Fraudulent Conveyance Act, see 9A Uniform Laws Annotated.

Section 14 of the Uniform Fraudulent Conveyance Act reads: "Sections are hereby repealed, and all acts or parts of acts inconsistent with this Act are hereby repealed."

to children, they had burden of proving maker's retention of sufficient assets to pay his debts. *Meehan v. Shreveport-Midorado Pipe Line Co.*, 164 A. 361, 107 Pa.Super. 530, 1933.

While under this chapter a plaintiff may proceed with an action to avoid a fraudulent conveyance without reducing his claim to judgment, an action to have a receiver appointed to insure collection from a corporation can be maintained only by a judgment creditor. *Lacocca v. Robbins*, 60 D. & C. 300, 22 Lehigh.L.J. 338, 1938.

Equity has jurisdiction to entertain a bill to set aside a conveyance made to defraud creditors. *Hatton v. Stein*, 29 Del. 235, 1940.

This act gives creditor choice of proceeding in equity or using common law remedy of judgment and execution on property alleged fraudulently conveyed. *Povillaitis v. Stainis*, 28 Luz. 18, 1932.

The remedy provided by 35 P.S. §§ 351-363, is concurrent with that provided by other acts of assembly which are proceedings at law, and a creditor has a choice of remedy where a conveyance is fraudulent as to him. *Kalka v. Borowitz*, 92 P.L.J. 469, 1945.

Preliminary objections to a bill in equity, which alleged a fraudulent conveyance of real estate under sections 351-363 of this title, were dismissed, where defendants contended lien of plaintiff's judgment had been lost through failure to revive lien within statutory period, and that plaintiff was barred by laches. *Id.*

The necessary facts must be established at a trial on merits, rather than by objections to bill. *Id.*

7. Decisions in other states

For notes of decisions in other states to identical section, see Uniform Fraudulent Conveyance Act, § 1, 9A Uniform Laws Annotated.

§ 352. Insolvency

(1) A person is insolvent when the present, fair, salable value of his assets is less than the amount that will be required to pay his probable liability on his existing debts as they become absolute and matured.

(2) In determining whether a partnership is insolvent, there shall be added to the partnership property the present, fair, salable value of the separate assets of each general partner in excess of the amount probably sufficient to meet the claims of his separate creditors, and also the amount of any unpaid subscription to the partnership of each limited partner, provided the present, fair, salable value of the assets of such limited partner is probably sufficient to pay his debts, including such unpaid subscription. 1921, May 21, P.L. 1045, No. 379, § 2.

Historical Note

Uniform Act:

This section is identical with the provisions of section 2 of the Uniform

Fraudulent Conveyance Act, see 9A Uniform Laws Annotated.

Evidence held sufficient to support decree annulling conveyances from husband to wife as having been made for purpose of defrauding creditors. *Id.*

In trustee's suit to set aside alleged fraudulent sale by bankrupt, part of consideration being stock in other corporations, evidence did not show transaction was fraudulent. *Wagoner v. Wallace Turnbull Corporation & Lumber Terminals*, 160 A. 105, 206 P. 442, 1932.

On question of grantor's solvency at time of conveyance, for purpose of determining whether conveyance was void as fraud on creditors under this section, annual capital stock returns made by grantor as officer of various corporations to auditor general, giving values of properties for purposes of state taxation, held competent only so far as they affected grantor's testimony as to their

net worth, and were not admissible against grantee who was not officer of corporations and had no part in making statements which were made after he received conveyance. *Jarvis v. Bell*, 146 A. 153, 296 P. 568, 1929.

In bankruptcy trustee's suit in ejectment, on ground that conveyance of land was in fraud of bankrupt's creditors, evidence held sufficient to warrant finding that bankrupt was abundantly solvent when he deeded land to his son, so that good title passed regardless of consideration, under this section. *Id.*

6. Decisions in other states

For notes of decisions in other states to identical section, see Uniform Fraudulent Conveyance Act, § 2, 9A Uniform Laws Annotated.

§ 353. Fair consideration

Fair consideration is given for property or obligation:

(a) When, in exchange for such property or obligation, as a fair equivalent therefor and in good faith, property is conveyed or an antecedent debt is satisfied; or

(b) When such property or obligation is received in good faith to secure a present advance or antecedent debt in amount not disproportionately small as compared with the value of the property or obligation obtained. 1921, May 21, P.L. 1045, No. 379, § 3.

Historical Note

Uniform Act:

This section is identical with the provisions of section 3 of the Uniform

Fraudulent Conveyance Act, see 9A Uniform Laws Annotated.

Notes of Decisions

Antecedent debt 3

Burden of proof, evidence 8

Consideration in general 2

Construction and application 1

Decisions in other states 9

Determination of fair consideration in general 6

Evidence 7, 8

Burden of proof 8

Family transactions 4

Security 5

1. Construction and application

An attorney for creditors of pledgor of a judgment against an estate, who attacked the pledge as constituting a fraudulent conveyance but negotiated a settlement whereby creditors paid \$500 for assignment of the judgment to their trustee, did not act in bad faith nor inconsistently with his duties as administrator d.b.n.c.t.a. of the judgment debtor estate in paying from es-



39 § 353 INSOLVENCY AND ASSIGNMENTS

Ch. 2

Note 6

and verdict in prior assumpsit suit in which plaintiff secured his judgment led to the conclusion that there was no fair consideration given for the deed and that transfer was a fraud on creditors, a finding to that effect should have been made. *Com. Trust Co. of Pittsburgh v. Cirigliano*, 41 A.2d 863, 352 Pa. 108, 1945.

On issue whether amount due from grantor to grantee for share of profits of venture conducted through corporations was sufficient to support grantor's conveyance of farm to grantee, as against attack that transfer was made to hinder, delay, and defraud grantor's creditors under this act, instruction that jury had right to consider testimony respecting profits, notwithstanding corporation's books were not introduced in evidence, because it was accepted without objection that there was a profit made, held not objectionable as stating that plaintiff admitted profits had been made, but it merely authorized jury to consider oral evidence as to profits which had been accepted without objection. *Jarvis v. Bell*, 146 A. 153, 296 Pa. 568, 1929.

7. Evidence

In action by trustee in bankruptcy to recover iron pledged by bankrupt, findings, which evidence supported, that fair consideration was given by pledgee to bankrupt in amount not disproportionately small as compared with value of iron, warranted conclusion as matter of law that transfer was not made with intent to hinder, delay or defraud creditors. *Commonwealth Trust Co. of Pittsburgh v. Reconstruction Finance Corporation*, 120 F.2d 254, C.C.A., 1941.

In suit to set aside a deed from mother to son as a fraudulent conveyance, as not supported by a fair consideration, defendants' testimony concerning fair consideration which was either in-

competent or vague and indefinite was insufficient to support a decree dismissing the bill. *Com. Trust Co. of Pittsburgh v. Cirigliano*, 41 A.2d 863, 352 Pa. 108, 1945.

8. — Burden of proof

In suit to set aside a deed from mother to son as a fraudulent conveyance, where only issue was whether a fair consideration was paid, burden was upon mother and son to show by clear and satisfactory testimony that full and fair consideration was paid which could only be done by establishing an express contract clearly proved by direct and positive testimony and in terms definite and certain. *Com. Trust Co. of Pittsburgh v. Cirigliano*, 41 A.2d 863, 352 Pa. 108, 1945.

To set aside as fraudulent a gift from a mother to her son, plaintiff had burden of proof to show the existence of a confidential relation, undue influence, or weakened intellect of the mother. *Gerner v. Kespelher*, 41 A.2d 860, 351 Pa. 649, 1945.

Where conveyance to child was for nominal consideration, burden is on child, as against parent's judgment creditor, to show that conveyance was fair. *Home Financiers' Building & Loan Ass'n v. Michael*, 177 A. 503, 117 Pa. Super. 391, 1935.

The burden of proof to show that a conveyance was made for a valuable consideration other than that set forth in the deed lies upon the grantee. It rests upon him to show that such a fair consideration was paid as to take the transaction out of the provisions of the statute. *Kehler Bros. v. Mikutavicz*, 6 Sch.Reg. 122, 1939.

9. Decisions in other states

For notes of decisions in other states to identical section, see Uniform Fraudulent Conveyance Act, § 3, 9A Uniform Laws Annotated.

§ 354. Conveyances by insolvent

Every conveyance made and every obligation incurred by a person who is or will be thereby rendered insolvent, is fraudulent as to creditors, without regard to his actual intent, if the conveyance is made or the obligation is incurred without a fair consideration. 1921, May 21, P.L. 1045, No. 379, § 4.

39 § 354 INSOLVENCY AND ASSIGNMENTS

Ch. 2

Note 18

recting reconveyance to deceased husband held erroneous. *Id.*

Where bill is filed against husband and wife by creditor of wife to set aside a deed made by wife to husband as trustee for their children, on ground that wife was insolvent and conveyance was fraudulent as to creditors, court may enter a decree declaring the deed void, notwithstanding children are not parties to suit. *Busch v. Jacobson*, 30 Del. 115, 1941.

Where the court decrees that land had been conveyed by the owner in fraud of the rights of a judgment creditor and that the lien of the judgment shall attach to the real estate, the lien

may be continued and revived notwithstanding the real estate has not been reconveyed to the defendant in the judgment. *Raub Supply Co. v. Brandt*, 27 Del. 507, 1938.

On decree that premises have been sold in fraud of judgment creditor and that lien shall attach to the property, the lien may be continued and in such case it is not necessary to bring in the fraudulent grantee as *terre tenant*. *Id.*

19. Decisions in other states

For notes of decisions in other states to identical section, see Uniform Fraudulent Conveyance Act, § 4, 9A Uniform Laws Annotated.

§ 355. Conveyances by persons in business

Every conveyance made without fair consideration, when the person making it is engaged, or is about to engage, in a business or transaction for which the property remaining in his hands after the conveyance is an unreasonably small capital, is fraudulent as to creditors, and as to other persons who become creditors during the continuance of such business or transaction, without regard to his actual intent. 1921, May 21, P.L. 1045, No. 379, § 5.

Historical Note

Uniform Act:

This section is identical with the provisions of section 5 of the Uniform

Fraudulent Conveyance Act, see 9A Uniform Laws Annotated.

Notes of Decisions

Construction and application 1
Decisions in other states 4
Evidence 3
Repeals 2

Miller v. Myers, 150 A. 588, 300 Pa. 192, 1930.

3. Evidence

Evidence showed that value of donor's assets after transferring life insurance policies in trust was unreasonably small capital to continue in speculative business on large scale so as to make transfer fraudulent as to creditors. *Fidelity Trust Co. v. Union Nat. Bank of Pittsburgh*, 169 A. 209, 313 Pa. 467, 1933, certiorari denied 54 S.Ct. 530, 291 U.S. 680, 78 L.Ed. 1068.

4. Decisions in other states

For notes of decisions in other states to identical section, see Uniform Fraudulent Conveyance Act, § 5, 9A Uniform Laws Annotated.

1. Construction and application

In determining "good faith" of transferee, as decisive of whether transfer is fraudulent against creditors, the question is solely whether transferee knew or should have known that he was not trading normally, and that on the contrary, purpose of the trade, as respects debtor, was to defraud creditors. *In re Messenger*, 32 F.Supp. 490, D.C. 1940.

2. Repeals

Bulk Sales Act (see Title 69, Sales), held not impliedly repealed by this act.

§ 356. Conveyances by a person about to incur debts

Every conveyance made and every obligation incurred without fair consideration, when the person making the conveyance or entering into the obligation intends or believes that he will incur debts beyond his ability to pay as they mature, is fraudulent as to both present and future creditors. 1921, May 21, P.L. 1045, No. 379, § 6.

Historical Note

Uniform Act:

This section is identical with the provisions of section 6 of the Uniform

Fraudulent Conveyance Act, see 9A Uniform Laws Annotated.

Notes of Decisions

Construction and application 1 Decisions in other states 2

1. Construction and application

Where judgment against trustee of oral trust to hold title to land was for goods sold and delivered to trustee two to nine months after trustee's reconveyance of land to beneficiary was recorded, trustee's creditors were not misled by record title in extending credit and principle of "estoppel" or "reputed ownership" was not available to creditors so as to enable them to set aside reconveyance as a "fraudulent conveyance". *Berenato v. Gazzara*, 31 A.2d 81, 346 Pa. 568, 1943.

That grantee in allegedly fraudulent conveyance was mother of one of grantors did not prevent transfer or sale of property discharging antecedent indebtedness. *Stalwart Building & Loan Ass'n v. Monahan*, 159 A. 189, 104 Pa. Super. 498, 1932.

Evidence supported chancellor's finding of adequate consideration for allegedly fraudulent conveyances of realty worth \$5,000, subject to mortgages exceeding \$4,200. *Id.*

2. Decisions in other states

For notes of decisions in other states to identical section, see Uniform Fraudulent Conveyance Act, § 6, 9A Uniform Laws Annotated.

§ 357. Conveyance made with intent to defraud

Every conveyance made and every obligation incurred with actual intent, as distinguished from intent presumed in law, to hinder, delay, or defraud either present or future creditors, is fraudulent as to both present and future creditors. 1921, May 21, P.L. 1045, No. 379, § 7.

Historical Note

Uniform Act:

This section is identical with the provisions of section 7, of the Uniform

Fraudulent Conveyance Act, see 9A Uniform Laws Annotated.

39 § 357 INSOLVENCY AND ASSIGNMENTS

Ch. 2

Note 28

as tenants by entireties for nominal consideration, parties attempting to sustain conveyance had burden to show transaction was fair to creditors. *Queen-Favorite Building & Loan Ass'n v. Burstein*, 165 A. 13, 310 Pa. 219, 1933.

Where a property is held as an estate by entireties by a father and mother and is conveyed to a son without a fair consideration, the Uniform Fraudulent Conveyance Act, implies fraud and renders the grantor insolvent as to his creditors. *Kehler Bros. v. Mikutavicz*, 6 Sch.Reg. 122, 1939.

29. Review

In action by trustee in bankruptcy to recover iron pledged by bankrupt, a justifiable finding of district court that no actual intent to defraud existed was conclusive on appeal. *Commonwealth Trust Co. of Pittsburgh v. Reconstruction Finance Corporation*, 120 F.2d 254, C.C.A., 1941.

30. Decisions in other states

For notes of decisions in other states to identical section, see Uniform Fraudulent Conveyance Act, § 7, 9A Uniform Laws Annotated.

§ 358. Conveyance of partnership property

Every conveyance of partnership property and every partnership obligation incurred, when the partnership is or will be thereby rendered insolvent, is fraudulent as to partnership creditors, if the conveyance is made or obligation is incurred:

(a) To a partner, whether with or without a promise by him to pay partnership debts; or

(b) To a person not a partner without fair consideration to the partnership as distinguished from consideration to the individual partners. 1921, May 21, P.L. 1045, No. 379, § 8.

Historical Note

Uniform Act:

This section is identical with the provisions of section 8 of the Uniform

Fraudulent Conveyance Act, see 9A Uniform Laws Annotated.

Notes of Decisions

Construction and application 1

Construction and application of former act 2, 3

Right to invoke provisions 3

Decisions in other states 4

Right to invoke provisions of former act 3

In re Messenger, 32 F.Supp. 490, D.C., 1940.

Under this section, sale of truck, which was subsequently sold for \$330 at public sale, for \$50 cash and \$175 by check, only \$120 of which was used to pay off wage claimants of the partnership, was fraudulent for lack of "fair consideration." *Id.*

1. Construction and application

In determining "good faith" of transferee, as decisive of whether transfer is fraudulent against creditors, the question is solely whether transferee knew or should have known that he was not trading normally, and that on the contrary, purpose of the trade, as respects debtor, was to defraud creditors.

2. Construction and application of former act

A confession of judgment by the general partner to a third person for money advanced to the special partner, which formed his contribution to the firm, was not valid as against the creditors of the firm under act 1836, March 21, P.L. 145 (now repealed), *Coffin's Appeal*, 106 Pa.

290, 1863; see *Dunning's Appeal*, 44 Pa. 150, 1863.

The 21st and 22d sections of act 1836, March 21, P.L. 145 (now repealed), as to transfers of partnership effects in contemplation of insolvency, applied only to existing partnerships, not to one which had been dissolved. *Pusey v. Dusenbury*, 75 Pa. 437, 1874; *Seibert v. Bakewell*, 87 Pa. 506, 1878.

Under act 1836, March 21, P.L. 145, § 21 (now repealed), a voluntary assignee of a limited partnership could not avoid an assignment made contrary to the provisions of the act; he represented only the assignors, not the creditors. *Bullitt v. Chartered Fund*, 26 Pa. 108, 1856.

A judgment confessed by one partner to another, to secure the amount of the capital advanced by such partner, who had agreed to enter into a special partnership, but became a general partner, by reason of non-compliance with the requirements of the act, was valid

against a separate creditor of the partner who confessed the judgment. *Purdy v. Lacock*, 6 Pa. 490, 1847.

A court of equity would not appoint a receiver of the effects of a special partnership, on the ground that a creditor of the firm was about to obtain judgment for a large amount, and to issue execution, whereby he would obtain a preference. *Beebe v. Boswell*, Com. Pleas, Phila., 22 January, 1853.

3. — Right to invoke provisions of former act

The provisions of act 1836, March 21, P.L. 145, § 23 (now repealed), avoiding transfers of individual property of partner, could only be invoked by the firm creditors. *Brooke v. Alexander*, 3 W.N. C. 304, 1876.

4. Decisions in other states

For notes of decisions in other states to identical section, see Uniform Fraudulent Conveyance Act, § 8, 9A Uniform Laws Annotated.

§ 359. Rights of creditors whose claims have matured

(1) Where a conveyance or obligation is fraudulent as to a creditor, such creditor, when his claim has matured, may, as against any person except a purchaser for fair consideration without knowledge of the fraud at the time of the purchase, or one who has derived title immediately or mediately from such a purchaser:

(a) Have the conveyance set aside or obligation annulled to the extent necessary to satisfy his claim; or

(b) Disregard the conveyance, and attach or levy execution upon the property conveyed.

(2) A purchaser who, without actual fraudulent intent, has given less than a fair consideration for the conveyance or obligation may retain the property or obligation as security for repayment.

(3) Knowledge that a conveyance has been made as a gift or for nominal consideration shall not by itself be deemed to be knowledge that the conveyance was a fraud on any creditor of the grantor, or impose any duty on the person purchasing the property from the grantee to make inquiry as to whether such conveyance was or was not a fraud on any such creditor. 1921, May 21, P.L. 1045, No. 379, § 9.

to second mortgagor, was fraudulent, held for jury. *Id.*

23. Review

Chancellor's finding that conveyance to wife was fraudulent as to husband's creditor, affirmed by court en banc, and supported by proof, held conclusive. *Hutterworth v. Wells*, 154 A. 491, 303 Pa. 302, 1931.

Verdict that purchasers paid fair consideration and were without knowledge

of vendor's fraud, if warranted by evidence, is conclusive on appeal. *Pennsylvania Trust Co. of Pittsburgh v. Schenecker*, 137 A. 272, 289 Pa. 277, 1927.

24. Decisions in other states

For notes of decisions in other states to similar section, see Uniform Fraudulent Conveyance Act, § 3, 3A Uniform Laws Annotated.

§ 360. Rights of creditors whose claims have not matured

Where a conveyance made or obligation incurred is fraudulent as to a creditor whose claim has not matured, he may proceed, in a court of competent jurisdiction, against any person against whom he could have proceeded had his claim matured, and the court may:

- (a) Restrain the defendant from disposing of his property;
- (b) Appoint a receiver to take charge of the property;
- (c) Set aside the conveyance or annul the obligation; or
- (d) Make any order which the circumstances of the case may require. 1921, May 21, P.L. 1045, No. 379, § 10.

Historical Note

Uniform Act:

This section is identical with the provisions of section 10 of the Uniform

Fraudulent Conveyance Act, see 9A Uniform Laws Annotated.

Notes of Decisions

Decisions in other states 4

Evidence 3

Restraining disposition of property 1

Setting aside conveyance 2

1. Restraining disposition of property

If claim has not been admitted or reduced to judgment and facts determined whether relation of creditor and debtor is shown to exist, then equity may restrain disposition of property by debtor. *First Nat. Bank of Mocanaqua v. DeMartin*, 28 Luz. 266, 1933.

2. Setting aside conveyance

Where husband and second wife each contributed \$3,500 toward erection of veterinary hospital owned by them as tenants by entireties, and, although second wife's contributions were inno-

cently made, husband's contributions were made with intent to defraud first wife, who was his creditor under a settlement agreement, and more than sum of husband's contribution to hospital was due first to wife under agreement, first wife was entitled to decree requiring payment of \$3,500 on account or, in default of payment, was entitled to execution against hospital provided that second wife's interest in hospital was to be protected in the execution to extent of her investment. *Amadon v. Amadon*, 59 A.2d 135, 359 Pa. 434, 1948.

Where a woman procures a loan from a bank on the strength of a financial statement showing herself to be the owner of certain real estate, part of which she later conveys without consideration to a straw man, who immediately re-conveys to the woman and her daughter jointly, and the remainder

Sec. 548. Fraudulent transfers and obligations

(a) The trustee may avoid any transfer of an interest of the debtor in property, or any obligation incurred by the debtor, that was made or incurred on or within one year before the date of the filing of the petition, if the debtor--

(1) made such transfer or incurred such obligation with actual intent to hinder, delay, or defraud any entity to which the debtor was or became, on or after the date that such transfer occurred or such obligation was incurred, indebted; or

(2)(A) received less than a reasonably equivalent value in exchange for such transfer or obligation; and

(B)(i) was insolvent on the date that such transfer was made or such obligation was incurred,

Exhibit "H"

or became insolvent as a result of such transfer or obligation; (ii) was engaged in business, or was about to engage in business or a transaction, for which any property remaining with the debtor was an unreasonably small capital; or (iii) intended to incur, or believed that the debtor would incur, debts that would be beyond the debtor's ability to pay as such debts matured.

(b) The trustee of a partnership debtor may avoid any transfer of an interest of the debtor in property, or any obligation incurred by the debtor, that was made or incurred on or within one year before the date of the filing of the petition, to a general partner in the debtor, if the debtor was insolvent on the date such transfer was made or such obligation was

incurred, or became insolvent as a result of such transfer or obligation.

(c) Except to the extent that a transfer or obligation voidable under this section is voidable under section 544, 545, or 547 of this title [11 USCS Sec. 544, 565, or 547], a transferee or obligee of such a transfer or obligation that takes for value and in good faith has a lien on any interest transferred, may retain any lien transferred, or may enforce any obligation incurred, as the case may be, to the extent that such transferee or obligee gave value to the debtor in exchange for such transfer or obligation.

(d)(1) For the purposes of this section, a transfer is made when such transfer becomes so far perfected that a bona fide purchaser from the debtor against whom such transfer could have been perfected cannot acquire an interest in the property transferred

that is superior to the interest in such property of the transferee, but if such transfer is not so perfected before the commencement of the case, such transfer occurs immediately before the date of the filing of the petition.

(2) In this section--

(A) "value" means property, or satisfaction or securing of a present or antecedent debt of the debtor, but does not include an unperformed promise to furnish support to the debtor or to a relative of the debtor; and

(B) a commodity broker or forward contract merchant that receives a margin payment, as defined in section 761(15) of this title [11 USCS Sec. 761(15)], takes for value.

(Nov. 6, 1978, P.L. 95-598, Title I, Sec.



101, 92 Stat. 2600.)

**Sec. 550. Liability of transferee of
avoided transfer**

(a) Except as otherwise provided in this section, to the extent that a transfer is avoided under section 544, 545, 547, 548, 549, or 724(a) of this title [11 USCS Sec. 544, 545, 547, 548, 549, or 724(a)], the trustee may recover, for the benefit of the estate, the property transferred, or, if the court so orders, the value of such property, from--

(1) the initial transferee of such transfer or the entity for whose benefit such transfer was made; or

(2) any immediate or mediate transferee of such initial transferee.

(b) The trustee may not recover under section (a)(2) of this section from--

(1) a transferee that takes for value, including satisfaction or securing of a present or antecedent



debt, in good faith, and without knowledge of the voidability of the transfer avoided; or

(2) any immediate or mediate good faith transferee of such transferee.

(c) The trustee is entitled to only a single satisfaction under subsection (a) of this section.

(d)(1) A good faith transferee from whom the trustee may recover under subsection (a) of this section has a lien on the property recovered to secure the lesser of--

(A) the cost, to such transferee, of any improvement made after the transfer, less the amount of any profit realized by such transferee from such property; and

(B) any increase in value as a result of such improvement, of the property transferred.

(2) In this subsection, "improvement"

includes--

- (A) physical additions or changes to the property transferred;
- (B) repairs to such property;
- (C) payment of any tax on such property;
- (D) payment of any debt secured by a lien on such property;
- (E) discharge of any lien against such property that is superior or equal to the rights of the trustee; and
- (F) preservation of such property.

(e) An action or proceeding under this section may not be commenced after the earlier of--

- (1) one year after the avoidance of the transfer on account of which recovery under this section is sought; and
- (2) the time the case is closed or

dismissed.

(Nov. 6, 1978, P.L. 95-598, Title I, Sec.
101, 92 Stat. 2601.)